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No 81-2394

IN THE

Supreme Court of the United States

OCTOBER TERM, 1981

WESTINGHOUSE ELECTRIC CORPORATION,
Appellant,

-against-

JAMES H. TULLY, JR., *et al.*,
AS THE TAX COMMISSION OF THE STATE OF NEW YORK,
Appellees.

ON APPEAL FROM THE COURT OF APPEALS OF THE STATE OF NEW YORK

JURISDICTIONAL STATEMENT

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June 30, 1982

QUESTIONS PRESENTED

1. Whether the grant by New York State of a large credit against the franchise tax payable by the corporate parent of a domestic international sales corporation ("DISC") *only* with respect to income attributable to shipments made from New York violates the Commerce Clause of the United States Constitution and the Equal Protection Clause of the Fourteenth Amendment to the United States Constitution?

2. Whether New York State's practice of combining the income of a DISC with that of its parent violates the Commerce Clause of the United States Constitution and the Due Process and Equal Protection Clauses of the Fourteenth Amendment to the United States Constitution, where New York State does not so combine the income of non-DISC subsidiaries and where the State uses that device to tax the income of other affiliates of the parent not doing business in New York.*

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* Westinghouse Electric Corporation was the respondent-appellant in the New York Court of Appeals. James H. Tully, Jr., Milton Koerner and Thomas H. Lynch, as the Tax Commission of the State of New York, were the appellants-respondents.

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-against-

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ON APPEAL FROM THE COURT OF APPEALS OF THE STATE OF NEW YORK

JURISDICTIONAL STATEMENT

DECISIONS OF THE COURTS AND AGENCY BELOW

The opinion of the New York Court of Appeals, dated April 1, 1982, is reported at 55 N.Y. 2d 364 and 449 N.Y.S. 2d 677, and is reprinted in the Appendix ("App.") at pages 1a-10a. The unpublished Order of the New York Appellate Division, Third Judicial Department, dated June 29, 1981, appears at App. 11a-12a. The decision of the Appellate Division, Third Judicial Department, dated June 18, 1981, is reported at 82 A.D. 2d 988 and 440 N.Y.S. 2d 397, and is reprinted at App. 13a-17a. The unpublished order of the Supreme Court of the State of New York transferring the proceedings to the Appellate Division, dated January 25, 1980,

appears at App. 18a-19a. The unpublished decision of the New York State Tax Commission, dated August 31, 1979, appears at App. 20a-26a.

JURISDICTIONAL BASIS OF THIS APPEAL

This is an appeal from a final judgment of the Court of Appeals of the State of New York which upheld provisions of New York law imposing a tax on the shareholders of a DISC against the contentions that the statute violated the Commerce Clause of the United States Constitution and the Due Process and Equal Protection Clauses of the Fourteenth Amendment to the United States Constitution. The decision of the Court of Appeals of New York was entered on April 1, 1982 (App. 27a). The Notice of Appeal was filed on June 28, 1982 (App. 28a-29a). This Court has jurisdiction of the appeal by virtue of 28 U.S.C. §1257(2).

CONSTITUTIONAL PROVISIONS AND STATUTES INVOLVED

Article I, §8, Clause 3 (the Commerce Clause) of the United States Constitution appears at App. 30a.

Article VI of the United States Constitution appears at App. 30a.

Amendment 14, §1 of the United States Constitution appears at App. 30a.

Sections 991-997 of the Internal Revenue Code of 1954, as amended, the provisions governing Federal taxation of DISCs as in effect for the relevant years, appear at App. 31a-55a.

New York Tax Law, Article 9-A, sections 208.1, 208.8-A, 208.9(a), 208.9(i), 209.6, 210.1-210.3, 210.13 and 211.1, the provisions governing the State franchise tax on DISCs as in effect during the relevant years, appear at App. 56a-67a.

STATEMENT OF THE CASE

Statement of Facts

As part of the Revenue Act of 1971, Congress—with the intention to "provide tax incentives for U.S. firms to increase their exports" and thereby to "improve our balance of payments"[1]—authorized the establishment of a unique new corporate entity known as a "Domestic International Sales Corporation" or "DISC". Internal Revenue Code of 1954 ("Code"), 26 U.S.C. §§991-997 (App. 31a-55a). A corporation qualifies as a DISC if substantially all of its gross receipts and assets are export related. Under the DISC provisions of the Code in effect in 1972 and 1973, the tax years here in question, and as relevant here, the income of a DISC was not taxed to the DISC at all (Code §991). Instead, a portion of its income was taxed to the DISC's shareholders (Code §995(a)). A minimum of one-half of the DISC's income was taxed to its shareholders on a current basis whether or not it was actually distributed (this income is known as "deemed distributions") (Code §995(b)). Taxes on the remainder were deferred until the income (known as "accumulated DISC income") was actually distributed or the corporation no longer qualified as a DISC (Code §995). Effectively, then, up to one-half of a DISC's income was not taxed at all under the 1971 Act for as long as it was retained by the DISC.

In response to the Federal legislation, New York in 1972 enacted the tax statute at issue here (App. 56a-67a) as an amendment to its general corporate franchise tax. In practical effect, New York sought to impose a franchise tax based on the *total* income of a DISC, including the half of that income as to which all Federal tax was deferred. In addition, with the specific purpose of encouraging export sales to be made through facilities in New York State, the New York law granted a substantial credit against the tax otherwise due with

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[1] S. Rep. No. 92-437 (92d Cong., 1st Sess.), *reprinted in* 1971 U. S. Code Cong. & Ad. News 1918, 1928.

respect to accumulated DISC income, but only to the extent that the DISC had income derived from products "shipped from a regular place of business of the taxpayer within [New York] state".[2] No credit was allowed for merchandise exported from locations in the United States outside of New York.

As stipulated by the parties below (App. 21a-26a), appellant Westinghouse Electric Corporation ("Westinghouse") is a Pennsylvania corporation engaged in the manufacture and sale of such products as electrical equipment, parts and appliances. Westinghouse is qualified to and does business in New York State, regularly paying corporate income and franchise taxes there. Westinghouse has a number of U.S. affiliates, however, which—as stipulated by respondents—do not do any business in New York ("non-New York affiliates").

Westinghouse owns all of the stock of Westinghouse Electric Export Corporation ("Westinghouse Export" or "Export"), which qualified as a DISC under §992(a) of the Code in 1972 and 1973. Westinghouse Export acted as a commission agent on behalf of both Westinghouse and its non-New York affiliates for export sales of products and related services manufactured in the United States during 1972 and 1973, and, as stipulated, all of its income consisted of commissions on such sales. Under Code §991, Westinghouse Export was exempt from Federal income tax for those years. In 1972 and 1973, Westinghouse Export had no employees in New York, did not engage in any business activities or maintain an office in New York, employed no capital in New York, did not own or lease real or tangible personal property in New York, paid no real estate rentals in New York, and did not file a New York corporate franchise tax return.

Westinghouse Export's total income in 1972 was just under $26 million; of this amount, about one-quarter was received from Westinghouse-affiliated companies not doing business in New York and the remainder was received from Westinghouse

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[2] N. Y. Tax Law §210.13(a). The credit effectively reduced the tax rate on such income by 70 percent.

itself.[3] On its 1972 Federal income tax return, pursuant to Code §995(b), and on its 1972 New York State franchise tax return, Westinghouse included as income, and paid taxes upon, one-half of Export's total income (or just under $13 million). Similarly, in 1973, the income of Westinghouse Export was nearly $58 million, of which almost one-fifth was received from non-New York affiliates and the remainder from Westinghouse; $29.8 million of Export's income was deemed distributed to Westinghouse under Code §995(b), was subject to Federal income tax and was reported on Westinghouse's New York State franchise tax return.[4] In both 1972 and 1973, Westinghouse incurred no Federal income tax liability for the approximately one-half of Export's income—its accumulated DISC income—that was not distributed.

This case arose when the New York State Tax Commission (whose members are appellees here) sought to include in Westinghouse's "entire net income" subject to the State franchise tax for 1972 and 1973 not only the amounts subject to Federal tax, but also the accumulated DISC income not subject to current Federal taxation. The State Tax Commission computed Westinghouse's franchise tax by combining all of Westinghouse Export's receipts, expenses, assets and liabilities with those of Westinghouse pursuant to N.Y. Tax Law §208.9(i)(B). The Commission then afforded Westinghouse a credit pursuant to N.Y. Tax Law §210.13(a), but only to the extent that the accumulated DISC income of Westinghouse Export was attributable to shipments made from a regular place of business in New York. Only about 5% of Export's receipts came from such New York shipments. As a result, the

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[3] Total Westinghouse Export income for 1972 was $25,987,000, of which $19,888,000 was received from Westinghouse and $6,099,000 from non-New York affiliates.

[4] More precisely, Export's 1973 income was $57,948,738, of which $47,180,132 was received from Westinghouse and $10,768,606 from non-New York affiliates. Deemed distributions from Westinghouse to Export were $29,838,006, on which the latter paid Federal income and State franchise taxes.

Commission alleged deficiencies in Westinghouse's franchise tax payments of $71,970 for 1972 and $151,436.76 for 1973. (App. 22a-25a.)

The Proceedings Below

In response to the State Tax Commission's notices of deficiency for 1972 and 1973, Westinghouse filed a petition, and later a perfected petition, for redetermination. The perfected petition alleged that, by requiring Westinghouse to compute its franchise tax liability by combining its receipts and expenses with those of Westinghouse Export, thereby taxing both Export's accumulated DISC income and its deemed distributions, appellees violated the Commerce Clause of the United States Constitution and the Due Process and Equal Protection Clauses of the Fourteenth Amendment. Westinghouse also contended that limiting the export credit to income attributable to shipments from New York violated the Commerce Clause and the Equal Protection Clause. The State Tax Commission rejected Westinghouse's contentions, concluding that "the constitutionality of the laws of the State of New York is presumed at the administrative level" (App. 26a).

Westinghouse reiterated all of its constitutional claims against the franchise tax in a petition to the New York Supreme Court under Article 78, N.Y.C.P.L.R., for review of the findings of the State Tax Commission. The Supreme Court transferred the proceeding to the Appellate Division, Third Judicial Department, for disposition (App. 18a-19a).

The Appellate Division, two justices dissenting, struck down a portion of the franchise tax. It held that N.Y. Tax Law §208.9(i)(B) was unconstitutional because it required Westinghouse Export's accumulated DISC income to be included in calculating Westinghouse's "entire net income" for franchise tax purposes. The Appellate Division did not reach Westinghouse's due process claim concerning accumulated income, nor did it decide the constitutionality of the tax credit. It did reject Westinghouse's due process and equal protection claims

against the taxation of deemed distribution income. (App. 13a-17a.)

The State Tax Commission appealed from that portion of the Appellate Division's decision that invalidated Section 208.9(i)(B), and Westinghouse cross-appealed to the extent that the Appellate Division had upheld the tax on deemed distributions. Westinghouse again raised the constitutional arguments that it had presented before the State Tax Commission and the Appellate Division, and which it now brings before this Court. The Court of Appeals rejected Westinghouse's constitutional claims and upheld the franchise tax in all respects. (App. 1a-10a.) Its judgment reversed the Appellate Division in part and reinstated the determination of the State Tax Commission. (App. 10a, 27a.)

THE QUESTIONS PRESENTED ARE SUBSTANTIAL

I. THE NEW YORK FRANCHISE TAX UNCONSTITUTIONALLY DISCRIMINATES AGAINST PERSONS EXPORTING PRODUCTS FROM OUTSIDE NEW YORK STATE BY SUBJECTING THE NEW YORK INCOME OF SUCH PERSONS TO A GREATER TAX THAN THE SAME AMOUNT OF NEW YORK INCOME IN THE HANDS OF A PERSON WHO EXPORTS PRODUCTS FROM WITHIN NEW YORK STATE.

Section 210.13(a) of the New York Tax Law provides a credit against the franchise tax otherwise payable by a corporation on account of accumulated DISC income retained by a DISC subsidiary. That credit is, however, granted in a constitutionally impermissible fashion: It applies only to that portion of a DISC's accumulated income that is attributable to export sales "shipped from a regular place of business of the taxpayer within [New York] state."[5] No credit is given for

[5] Technically, the credit was computed for Westinghouse by first calculating the ratio of Westinghouse's receipts from export sales on which Westinghouse Export received commissions that were "shipped

sales of products shipped overseas from a place of business outside of New York State. The credit is equal to 70% of the tax otherwise payable on account of the accumulated DISC income.

The avowed purpose of the credit was to pressure firms engaged in the export trade to locate their operations in New York State.[6] As the Court of Appeals noted:

> "The credit was devised . . . to provide shareholders of DISCs with State tax incentives akin to those that had been enacted by the Federal Government. Such credit was intended to ensure that New York would not lose its competitive position vis-a-vis other States which were also expected to offer tax benefits to DISC owners. While Congress chose to provide the benefit in the form of a tax deferral, our State Legislature elected to use a tax credit." (App. 7a-8a; citations omitted.)

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from a regular place of business of the taxpayer in [New York] state" to the total receipts on the sale of export property on which Export received commissions. That ratio was 4.7% for 1972 and 5.5% for 1973. The ratio was then multiplied by Westinghouse Export's accumulated DISC income for each of those years, with the products representing the sums eligible for the credit. The respective products were then multiplied by Westinghouse's business allocation percentage as calculated under New York's usual allocation formula (which is not itself challenged here except for the manner of its application to DISC income). This product represents that portion of the accumulated DISC income allegedly subject to New York tax and attributable to New York shipments. The credit is equal to 70% of that amount times the tax rate, which was 9% in 1972 and 1973. (See App. 23a-25a.)

[6] For example, the report of the State Division of the Budget supporting enactment of the credit noted that the credit would be "a means of providing a positive incentive for increased export business activity in New York State" and would "result in an indeterminable but perhaps significant improvement in the State's economy"; the report rejected the notion of "full taxation of DISCs" because that "would undoubtedly encourage their formation outside the State". New York State Division of the Budget Report in bill jacket [at pp. 6, 8] of L. 1972, ch. 779.

What the Court of Appeals failed to recognize is that—while it is perfectly proper for the Federal government to encourage American firms to export products from this country for the purpose, for example, of increasing employment and improving our international balance of payments—it is unconstitutional under our Federal system for a state to encourage businesses to locate within its borders by means of a tax that discriminates against business operations conducted in other states. *E.g., Maryland v. Louisiana*, 101 S. Ct. 2114 (1981); *Boston Stock Exchange v. State Tax Comm'n*, 429 U.S. 318 (1977); *cf. International Harvester Co. v. Evatt*, 329 U.S. 416 (1947); *International Harvester Co. v. Dep't of Treasury*, 322 U.S. 340 (1944); *McGoldrick v. Berwind-White Coal Mining Co.*, 309 U.S. 33 (1940); *Western Live Stock Co. v. Bureau of Revenue*, 303 U.S. 250 (1938).

The formula employed by New York in section 210.13(a) to calculate the franchise tax credit has the effect of taxing the same amount of income allocated to New York by two different taxpayers at different rates depending on the state from which the taxpayer chooses to ship its products. For example, assuming a tax rate of 10%, a corporation with accumulated DISC income of $1000, half of which is allocable to New York, will pay $50 in tax if it ships its goods from New Jersey. But a firm with the same accumulated DISC income, of which the same one-half is allocable to New York—but shipping its goods from New York—will pay only $15 in tax. Thus, New York substantially penalizes a taxpayer for shipping from New Jersey. This is precisely the kind of discrimination that is forbidden by the Commerce Clause.

This Court has repeatedly struck down similar discriminatory attempts by states to provide tax advantages to business activity within their borders at the expense of other states. For example, in *Boston Stock Exchange v. State Tax Commission*, this Court struck down under the Commerce Clause an amendment to the New York stock transfer tax by which (a) the tax payable by nonresidents was cut in half when the transaction involved an in-state sale but not when it

involved an out-of-state sale; and (b) a maximum tax of $350 was applied to a single transaction (by either a resident or a nonresident) when the sale took place in-state but not when it took place elsewhere. This Court held both provisions unconstitutional because "[n]o State, consistent with the Commerce Clause, may 'impose a tax which discriminates against interstate commerce . . . by providing a direct commercial advantage to local business' ". 429 U.S. at 329 (citations omitted). Like the transfer tax in *Boston Stock Exchange*, the franchise tax in this case "imposes a greater tax liability on out-of-state sales than on in-state sales," and therefore "falls short of the substantially even-handed treatment demanded by the Commerce Clause". *Id.* at 332.

In *Maryland v. Louisiana*, this Court applied the same principles to strike down Louisiana's severance tax on natural gas, under which in-state users of gas paid a lower tax through exemptions and credits than out-of-state purchasers. 101 S. Ct. at 2132-36. Significantly, the Court noted that the basic purpose of the Commerce Clause was "to prohibit the multiplication of preferential trade areas", *id.* at 2133, which is precisely the vice from which New York's franchise tax credit suffers. Under *Boston Stock Exchange* and *Maryland v. Louisiana*, the New York tax must be struck down.

The Court of Appeals erred when it upheld New York's discriminatory tax credit on the ground that the State is merely forgiving a portion of a tax which it is otherwise constitutionally entitled to impose. While that premise is faulty, as is shown below, even assuming it to be correct, the argument proves too much. It could be used to justify any discriminatory tax so long as the legislature first levied a proper tax and then forgave all or a portion of it to the favored few. But the class whose tax is forgiven also must be chosen in a constitutionally legitimate manner. New York would never contend that, since it may constitutionally impose an equal sales tax on all transactions within the State, it could also forgive 70% of that tax when a sale was made by a merchant belonging to a particular racial or religious group. Similarly, the Commerce Clause guarantees

substantially equal treatment to an export business whether it is conducted inside or outside New York.

In addition, the franchise tax violates the Equal Protection Clause. By imposing a different effective tax rate depending upon the locus of export sales activity, it fails to treat export businesses operating across state lines in the same manner as such businesses operating entirely within New York. But once a state allows foreign corporations to do business within its borders, "the adopted corporations are entitled to equal protection with the state's own corporate progeny". *Wheeling Steel Corp. v. Glander,* 337 U.S. 562, 571 (1949) (striking down state law that taxed intangibles of foreign but not domestic corporations). *See also Allied Stores of Ohio, Inc. v. Bowers,* 358 U.S. 522, 527 (1959).[7]

II. NEW YORK'S REQUIREMENT THAT THE INCOME OF WESTINGHOUSE'S NON-NEW YORK DISC SUBSIDIARY BE COMBINED WITH THAT OF ITS PARENT IS UNCONSTITUTIONAL.

The question of the proper boundaries of the states' powers to tax DISCs is one of national importance. As of tax year 1979, according to Treasury Department statistics, there were some 7,200 DISCs with total gross receipts of almost $100 billion, net income of $6.4 billion and tax deferred income of over $2 billion.[8] The Treasury estimated that the existence of

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[7] Moreover, the discriminatory purpose of the credit to pressure export shippers to locate in New York is furthered by the fact that the franchise tax (apart from the credit) impermissibly distinguishes between dividends paid to a parent corporation by DISC subsidiaries (all of which are taxed to the parent) and dividends paid by all other corporate subsidiaries (which in general are not subject to the franchise tax, N. Y. Tax Law §208.9(a)(1)). The result is that in the case of non-DISC subsidiaries, none of the income of the subsidiary is taxed to the parent, even if all of it is actually distributed to the parent. In the case of a DISC, all of the income is taxed to the parent, even if none is in fact distributed.

[8] U.S. Department of the Treasury, 1979 Annual Report: The Operation and Effect of the Domestic International Sales Corporation Legislation (April 1981) ("DISC Report") at 28 (Table 5-2). The

the DISC legislation resulted in an increase in United States exports in 1979 of between $4.5 billion and $7 billion.[9]

Yet by singling out DISCs for special, disparate tax treatment, New York undermines this important national policy. It creates an impermissible conflict between state and national policy in the area of foreign trade—an area in which it is vital that the nation speak "with one voice". *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434, 449 (1979). As the Appellate Division correctly held in this case:

> "The DISC provisions of the Code being unmistakably aimed at improving foreign commerce, any state impediment hindering that congressional intent is not constitutionally allowable." (App. 15a.)

Congress carefully designed the DISC provisions of the Code not only "to provide tax incentives for U.S. firms to increase their exports . . . but also to remove a present disadvantage of U.S. companies engaged in export activities through domestic corporations".[10] Prior to enactment of the DISC provisions, such firms were "treated less favorably than [American] firms which manufacture abroad through the use of foreign subsidiary corporations".[11] In the former case, the United States corporation was fully and immediately taxable on its entire income from export sales. In the latter case, foreign tax might be minimal and United States tax was imposed only when (and if) income was remitted to the United States parent as a dividend. Congress' solution was to exempt the DISC from tax, to tax a portion (approximately 50%) of the DISC's income currently to its shareholders and to defer tax on the

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DISC statute was amended in some respects by the Tax Reduction Act of 1975, 89 Stat 26, and the Tax Reform Act of 1976, 90 Stat. 1525.

[9] DISC Report at 2.

[10] H. R. Rep. No. 92-533 (92d Cong., 1st Sess.), *reprinted in* 1971 U. S. Code Cong. & Ad. News 1825, 1872. *See also* S. Rep. No. 92-437, *supra*, 1971 U.S. Code Cong. & Ad. News at 1996.

[11] *See* note 10 *supra*.

remaining accumulated DISC income. Congress thus intended to encourage domestic production of goods for export by eliminating the tax advantages created by overseas production.

The New York franchise tax, however, is irremediably inconsistent with the Federal tax structure. New York has attempted to tax the accumulated DISC income which Congress decided to leave untaxed. Such a tax cannot help but stand "as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress" and therefore is invalid. *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941). As the Appellate Division held, this aspect of the franchise tax unconstitutionally "diminish[es] the tax advantages Congress bestowed on United States corporations engaged in foreign trade" (App. 15a).

This Court's decision in *McGoldrick v. Gulf Oil Corp.*, 309 U.S. 414 (1940), invalidating a New York City tax, is particularly instructive in this respect. In that case, the City sought to impose a sales tax upon oil sold locally to ships engaged in foreign commerce. The oil was exempt from Federal excise taxes under the Revenue Act of 1932, but that statute contained no express exemption from state taxes. This Court found that the exemption from Federal taxation expressed a Congressional intent "to enable American refiners to meet foreign competition and to recover trade which had been lost", *id.* at 427. The Court concluded:

> "It is evident that the purpose of the Congressional regulation of the commerce would fail if the state were free at any stage of the transaction to impose a tax which would lessen the competitive advantage conferred on the importer by Congress, and which might equal or exceed the remitted import duty." *Id.* at 429.

Thus, even absent specific preemptive language, this Court looked to the broad purposes of Congress' use of the taxing power to encourage foreign commerce. The same principles apply here and the court below should have reached the same

result.[12] If anything, this case is stronger for the taxpayer than *McGoldrick*, since that case involved a sales tax of general applicability, while in the present case, New York has singled out DISCs for special taxation.

New York's practice of singling out DISC subsidiaries for special treatment further flaws its tax scheme. The franchise tax, as it applies to both deemed distributions and accumulated DISC income, "'in its practical operation work[s] discrimination against interstate commerce.'" *Maryland v. Louisiana*, 101 S. Ct. at 2134 (citations omitted). It does so by requiring that all of a DISC's income be combined with that of the parent corporation and then applying the State's business allocation percentage to the combined entity. This contrasts with New York's uniform practice for all non-DISC corporate subsidiaries under which income and business allocation percentages are computed separately for the subsidiary and the parent. In this case, where the business allocation percentage of Westinghouse Export taken alone would be zero,[13] the effect of automatically combining the income of Westinghouse and Export is impermissibly to increase the share of Export's income that is subject to taxation by New York. Since all of Export's

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[12] The *McGoldrick* decision did not turn, as the Court of Appeals suggested (App. 6a), on the technical conditions that Congress imposed on the handling of the oil to qualify for the tax exemption. In any event, Congress imposed analogous conditions on corporations seeking treatment as DISCs, conditions indisputably met in this case.

Nor does the brief comment in the legislative history relied on by the Court of Appeals (App. 5a-6a) support its conclusion that Congress intended to permit state taxation of DISCs which would undermine the Federal law. At most, the comment indicates that states may tax DISCs only to the same extent as the Federal government taxes them by "piggybacking on the Federal corporate income tax". *See* Hearings Before the House Committee on Ways and Means on Tax Proposals Contained in the President's New Economic Policy (92d Cong., 1st Sess.), Part 1 at 171 (1971).

[13] It is stipulated that Export had no employees or property in New York, and by definition it had no receipts from sales in New York because it delivered all of the products that it sold abroad. *See* N. Y. Tax Law §210.3.

income is derived from foreign commerce, the effect of the tax is to single out income from such trade for greater taxation than subsidiary income from other sources, in violation of the Commerce Clause and the Equal Protection Clause. By collapsing the income of a DISC subsidiary which does no business in the State with that of its parent, New York is attempting to impose franchise taxes on export income having no connection with the State, and it is pressuring taxpayers to shift the activities giving rise to that income into the State of New York by means of the credit described in Point I above.

Because the Federal tax rules for DISCs represent a specific Congressional regulation of foreign commerce, they are—even as compared with regulation of domestic interstate commerce—entitled to special protection from state interference. " '[T]he Government must speak with one voice when regulating commercial relations with foreign governments.' " *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. at 449, quoting *Michelin Tire Corp v. Wages*, 423 U.S. 276, 285 (1976). The New York tax creates a conflict between state and Federal policies which prevents the United States from "speaking with one voice" and disrupts our foreign commerce. It is, therefore, invalid under the Commerce Clause.

Finally, New York's action in disregarding the corporate existence of Westinghouse Export, and subjecting its income to tax irrespective of its contacts with New York, is a violation of the Due Process Clause. Westinghouse Export has no employees, property or sales in New York. Approximately 20-25% of Westinghouse Export's income is derived from export sales on behalf of Westinghouse affiliates which do not do business in New York. Appellees have never claimed that those non-New York affiliates are part of a unitary business with Westinghouse or are otherwise taxable in New York. Yet the Court of Appeals held that Export, through its Westinghouse parent, is taxable on income derived from export sales on behalf of such non-New York affiliates, irrespective of whether they are part of a unitary business with Westinghouse. That holding is plainly wrong.

"[D]ue process requires some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax." *Miller Bros. Co. v. Maryland*, 347 U.S. 340, 344-45 (1954). The Court of Appeals' reliance (App. 6a-7a) on the "unitary business" concept, *see, e.g., Mobil Oil Corp. v. Commissioner*, 445 U.S. 425 (1980), is misplaced. Neither in *Mobil* nor in any other case has this Court sustained the taxation of one corporate entity (Westinghouse) on income earned and retained by another entity (Westinghouse Export) derived from dealings with other entities (Westinghouse's non-New York affiliates) not subject to the jurisdiction of the taxing state.

Respondents' attempt to tax the income of Westinghouse Export thus represents an attempt to impose taxes on income having no nexus with activities in New York in an amount which bears no reasonable relation to the intrastate values involved. Accordingly, it violates the Due Process Clause of the Fourteenth Amendment.

CONCLUSION

For the foregoing reasons, probable jurisdiction should be noted and the case set for argument.

June 30, 1982

Respectfully submitted,

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APPENDIX

DECISION OF THE COURT OF APPEALS

STATE OF NEW YORK COURT OF APPEALS

No. 97

In the Matter of WESTINGHOUSE ELECTRIC CORPORATION,

Respondent-Appellant,

v.

JAMES H. TULLY, JR., et al., constituting the Tax Commission of the State of New York,

Appellants-Respondents.

Argued February 9, 1982; decided April 1, 1982

Robert Abrams, Attorney-General (Francis V. Dow and Shirley Adelson Siegel of counsel) for appellant.

Henry W. deKosmian and Simon Friedman, for respondent.

OPINION OF THE COURT

FUCHSBERG, J.:

In an article 78 proceeding to review a determination of the State Tax Commission which sustained corporate franchise taxes imposed pursuant to Article 9-A of the Tax Law, we are called upon to pass on the constitutionality of New York statutes which tax income emanating from the earnings of a "domestic international sales corporation" (hereinafter referred to by the acronym "DISC"), a class of corporations newly made eligible for preferential tax treatment by the Federal Revenue Act of 1971.

The primary requirement for qualification as a DISC is that a corporation must derive at least 95 per cent of its income from export sales and related services. The tax advantages it receives are intended to encourage the export of goods manufactured in the United States by compensating for the far lower taxes many foreign subsidiaries of American companies pay to the nations in which they operate (*see* H. Rep. No. 92-533, 92d Cong., lst Sess., [1971], reprinted in US Code Cong. & Admin. News 1825, 1872; S. Rep. No. 92-437, 92d Cong., lst Sess., [1971], reprinted in US Code Cong. & Admin. News 1918, 1928, 1996). To effect the contemplated tax benefit, the implementing statute, besides exempting a DISC from Federal taxation, permits half of its income to be "accumulated" without subjecting its shareholders to current Federal taxes. On the other hand, the other half is "deemed distributed" to the shareholders even if it in fact is not paid out as a dividend (*see* US Code, tit 26, § 991 *et seq.*).[1]

The DISC involved in the present proceeding, a Delaware corporation named Westinghouse Electric Export Corporation, is a wholly-owned subsidiary of Westinghouse Electric Corporation (Westinghouse), a Pennsylvania corporation which does business in New York. It is undisputed that all of the DISC's business income for 1972 and 1973, the years under review here, was earned as commission agent for either Westinghouse or the latter's affiliates.[2] Moreover, it is agreed that none of the usual incidents of a nexus with New York applied to the DISC, it having operated no office, engaged no employees, conducted no business activities, employed no capital and neither owned nor leased real or tangible personal property. Concordantly, it did not file New York franchise tax returns.

It was against this background that, when Westinghouse filed its 1972 and 1973 New York franchise tax returns, though it

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[1] Since no questions are raised as to the tax ramifications of an actual distribution of DISC income or the eventual taxability of the accumulated DISC income, we do not treat with such issues in this opinion.

[2] None of the affiliates did business in New York.

included its "deemed distributions" from the DISC in its "entire net income" (*see* Tax Law, § 208.9[a][1]), it did not charge itself with any portion of the "accumulated" DISC income. Finding these returns deficient, New York State's Department of Taxation and Finance took the position that Westinghouse, in its treatment of the DISC income, had failed to comply with Tax Law, § 208.9(i)(B), which, in essence, requires a reporting corporation to compute its "entire net income" by consolidating its DISC's receipts, expenses, assets and liabilities with its own, save for transactions between it and its DISC. Such consolidation, of course, would have added the accumulated DISC income which had been deferred for Federal tax purposes.[3] Against the deficiency assessed on this basis, the Department did allow Wesinghouse a DISC export credit for merchandise "shipped from a regular place of business of the taxpayer within this state", all pursuant to a formula set out in section 210.13(a) of the Tax Law (*see infra* p. 7).

In its petition for a redetermination, Westinghouse alleged that inclusion of accumulated DISC income in its "entire net income" would impose an undue burden on interstate and foreign commerce (US Const, art I, § 8, cl 3);[4] that, in violation

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[3] Tax Law § 208.9(i)(B), in pertinent part, reads: "[A]ny taxpayer required to compute a tax under this article, which during the taxable year being reported was a stockholder in any DISC . . . shall . . . adjust each item of its receipts, expenses, assets and liabilities, as otherwise computed under this article, by adding thereto its attributable share of each such DISC's receipts, expenses, assets and liabilities . . . provided, however, (1) that all transactions between the taxpayer and each such DISC shall be eliminated from the taxpayer's adjusted receipts, expenses, assets and liabilities; (2) that the taxpayer's entire net income as otherwise computed under this section, shall be reduced by subtracting the amount of the deemed distribution of current income, if any, from each such DISC already included in the entire net income of such taxpayer by virtue of having been included in its entire taxable income for that taxable year as reported to the United States Treasury Department".

[4] The commerce clause provides that "The Congress shall have Power . . . to regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes."

of the due process clauses of the State and Federal Constitutions, New York lacked a jurisdictional nexus upon which to tax the DISC's income; and that, if the DISC's accumulated income had to be included in "entire net income", Tax Law, § 210.13(a), which provides the tax credit, offends the commerce clause because it discriminates against shipments of export property from locations outside the State. In addition, Westinghouse, asserting that State taxation of the deemed distributions of DISC trespassed on due process and equal protection, demanded that the taxes it had paid on such be refunded.[5] The State Tax Commission rejected all of these contentions.

For its part in this proceeding, the Appellate Division, two justices dissenting, found that section 208.9(i)(B), in requiring the DISC's accumulated income to be added to the taxpayer's "entire net income", constituted an unconstitutional imposition on foreign commerce. Having found that 208.9(i)(B) violated the commerce clause, the court did not address Westinghouse's claim that the provision was also invalid for lack of due process. Nor did the court decide the constitutionality of the tax credit of 210.13[a], apparently because this section expressly is made dependent on the validity of 208.9(i)(B). Finally, it rejected Westinghouse's due process and equal protection contentions regarding the inclusion of the deemed distribution income. For the reasons which follow, we believe none of the constitutional objections has merit.

Turning at once to Westinghouse's primary argument —that the addition of the accumulated DISC income to Westinghouse's "entire net income" as called for by Tax Law § 208.9(i)(B) frustrates the efficacy of the Federal tax incentive and, therefore, runs counter to the fundamental policy dictates of the commerce clause—we first pay heed to the well-settled proposition that the ultimate power to regulate both

[5] Westinghouse also contended that the State Tax Commission had transposed certain numbers creating an arithmetical miscalculation of the tax. In its answer, the Commission conceded this error.

foreign and interstate commerce lies with Congress (*see, e.g., Gibbons v. Ogden*, 9 Wheat [22 US] 1,86-87). However, that a State chooses to act in the same field as does Congress does not automatically portend judicial nullification of the State law (*see Walhalla Associates, Inc. v. National Commercial Bank and Trust Co.*, 54 N.Y.2d 857; *see, generally*, Tribe, American Constitutional Law, § 6-24, p. 379). It all hinges on whether Congress intended to preempt State regulation (*see Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 229-230).

This said, we note that in the present case there is no explicit statement of preemption. Nor does the statutory scheme imply any such design. True, it bespeaks a plan to give special tax treatment to DISCs and their stockholders in order to encourage export sales of goods manufactured in the United States. But that some benefits were extended to accomplish this end does not mean that every possible kind was intended. To the contrary, even as to Federal taxation, the incentives tendered a DISC's shareholders, the ultimate beneficiaries of a DISC's tax preferment, are far more limited than those offered to the DISC per se.[6]

Most persuasive is the relevant legislative history. This leaves little to implication. On September 8, 1971, shortly before the DISC legislation was enacted, John S. Nolan, Deputy Assistant Secretary of the Treasury for Tax Policy, spokesman for the sponsoring department, in the company of then Secretary of Treasury John B. Connally, officially appeared at a hearing before the Committee on Ways and Means of the House of Representatives. There, Mr. Nolan, in response to an expression of committee concern that the proposal might "prohibit States from levying corporate income taxes on a DISC" was unequivocal in his declaration that the proposed bill would leave the States "free to impose the tax, if they choose to do so" (*see* Hearings before House Committee on Ways and

[6] We also observe that even accumulated DISC income is taxable to the shareholders when it is distributed, when a shareholder sells his stock or when the corporation no longer qualifies as a DISC (*see* US Code, tit 26, § 995).

Means on the Tax Proposals Contained in the President's New Economic Policy, 92nd Cong., 1st Sess., Part I, pp. 170-171). Moreover, not without significance, proposed legislation which might have preempted the States from taxing DISCs was considered by the same committee in 1980, only to be permitted to die without any action (*see* HR 5076, 96th Cong., 2nd Sess.; Hearing before Committee on Ways and Means on State Taxation of Foreign Source Income, p. 29, 326). Overall, then, our State is far from constrained by a clear statement that Congress intended to exercise its commerce power in full (*see* Tribe, American Constitutional Law, § 5-8, p. 243).

On this point, comments also are in order on *McGoldrick v. Gulf Oil Corp.* (309 U.S. 414) to which Westinghouse adverts to support its position. There, a Federal statute permitted the importation of crude petroleum into the United States free of import duty. However, the statute specified that the petroleum be imported, converted into fuel oil and then sold solely for fuel in propelling foreign-bound vessels in foreign commerce, all while in bond. These *congressionally-designed* conditions prevented the segregated oil from ever becoming a part of "the common mass of property in the state" (*McGoldrick, supra,* at p. 423). The Supreme Court emphasized that it was this integrated structure for assuring that the oil never left the stream of foreign commerce, which has no parallel in this case, that compelled the conclusion that "while in bonded warehouse, [the oil is] free from state taxation" (*McGoldrick, supra,* at pp. 428-429).

The second prong of Westinghouse's constitutional attack on section 208.9(i)(B) is that, since neither the DISC nor any of Westinghouse's affiliates for which it acted as export commission agent were engaged in business in New York, the State lacked the jurisdictional nexus to satisfy the minimal due process standards on which the right to tax must be predicated. We find this assertion equally without merit. Revealing in this connection is the recent decision in *Mobil Oil Corporation v. Commissioner of Taxes* (445 U.S. 425). In the context of a challenge to Vermont's taxation of dividend income received by

a taxpayer from foreign subsidiaries and affiliates, the court reminded us that in such a case, due process mandates can be met by a State's apportionment formula so long as it is reasonably designed to reflect the percentage of a unitary business' profits connected with the State (*see Mobil Oil, supra,* at pp. 436-440; *cf. American Ins. Assn. v. Lewis,* 50 N.Y.2d 617, 623-624).

Here the record shows that Westinghouse and its DISC were operating a unitary business. Not all the accumulated DISC income was subjected to taxation, but rather only that part allocable to New York (Tax Law, §§ 208.9[i][B], 210.1[a], 210.3; *cf. Fischbach & Moore v. Tax Comm.,* 36 N.Y.2d 605, 607). Moreover, there is nothing in the record to show that the income was improperly apportioned to business done in New York; nor does the taxpayer question our State's allocation formula.[7]

This brings us to the Westinghouse argument that, even if the inclusion of the accumulated DISC income required by section 208.9(i)(B), standing alone, does not contravene the commerce clause, an infringement occurs when it is acted upon by the tax credit provided for in section 210.13(a). It reasons that the effect of the credit is impermissibly to subject its export sales from a non-New York "place of business" to a higher rate of tax than comparable sales "shipped from a regular place of business" within New York.

The credit was devised, by the State on its own, to provide shareholders of DISCs with State tax incentives akin to those which had been enacted by the Federal government (*see* Letter from Norman F. Gallman, Commissioner of Taxation and Finance to Governor Nelson A. Rockefeller in bill jacket [at p.

[7] Tax Law § 210.3 provides for an allocation of a taxpayer's total business income from all sources by the application of a three-factor formula, the three factors being the fractions represented by a taxpayer's property within New York over all its property, a taxpayer's payroll within New York over its total payroll and a taxpayer's receipts from within New York over its total receipts.

3-4] of L 1972, ch 778; Memorandum of Department of Commerce in bill jacket [at p. 12] of L 1972, ch 778; Division of the Budget Report in bill jacket [at p. 19] of L 1972, ch 778). Such credit was intended to ensure that New York would not lose its competitive position vis-a-vis other States which were also expected to offer tax benefits to DISC owners (*see* Letter from Arthur M. Arnold, Director of Taxation and Governmental Affairs of the Empire State Chamber of Commerce in bill jacket [at p. 28] of L 1972, ch 778; Memorandum in Support by New York Chamber of Commerce in bill jacket [at p. 29] of L 1972, ch 778). While Congress chose to provide the benefit in the form of a tax deferral, our State Legislature elected to use a tax credit.

That a State's tax structure is so used hardly requires an *ipso facto* finding that we have discriminated against multi-state enterprises in favor of intrastate corporations. Rather, States are free to use their taxing power "to encourage the growth and development of intrastate commerce and industry . . . [and to] compete with other States for a share of interstate commerce; such competition lies at the heart of a free trade policy" (*Boston Stock Exchange v. State Tax Commn.*, 429 U.S. 318, 336-337). That this is what the credit allowed by § 210.13(a) accomplishes, and no more, is demonstrated by a review of how it is calculated.

The first step to be taken to arrive at the amount of such tax credit is to multiply the taxpayer's share of the accumulated DISC income by the taxpayer's New York "business allocation percentage" (Tax Law, § 210.3). This yields the dollar value of the accumulated DISC income allocable to New York as *in-state* earnings. This amount is then multiplied by that percentage which the taxpayer's receipts from export property on which the DISC earned commissions *and* which was shipped from a regular place of business in New York bears to the taxpayer's total receipts from the sale of export property on which the DISC earned commissions. The product of this calculation is the amount eligible for the credit; it is merely a

subdivision of the accumulated DISC income allocable to New York.[8]

Obviously, the business allocation percentage plays an integral role in computing the tax credit. It determines what amount of the taxpayer's income has a jurisdictional nexus with the State. The result is that, when the State exercises its taxing power, it does so consistently with due process mandates (*Northwestern Cement Co. v. Minnesota*, 358 U.S. 450; *Wisconsin v. Penney Co.*, 311 U.S. 435).

But New York need not tax all which it has the right to tax. The credit here simply forgives a portion of that income which New York may tax by reference to shipments of export property from a regular place of business in New York, an additional New York relationship. Such a method clearly satisfies due process, and any effect on interstate commerce is too indirect to run afoul of the commerce clause.

Now, having disposed of the arguments on which Westinghouse seeks to overturn the Tax Commission's assessment, we treat with its claim for reimbursement of its allegedly mistaken payment of tax on the deemed distributions. Its position, again cast in constitutional terms, is that taxation of such income infringes upon both due process and equal protection.

Its alleged due process position is no different from the one it took regarding taxation of accumulated DISC income, *i.e.*, New York lacks a sufficient nexus with the DISC to tax its income. But, since Westinghouse and the DISC are parts of a unitary business and there is an apportionment of the income

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[8] The dollar value of the credit is then determined by multiplying the amount available for the credit by 70% and then by the tax rate (Tax Law, § 210.13[a]). According to a memorandum prepared by the State Department of Commerce before the DISC legislation was enacted, "[t]he 70 percent factor included in the export credit formula [was] apparently designed to minimize revenue loss while still providing some tax incentive for the export business" (Memorandum of Department of Commerce in bill jacket [at p. 12] of L 1972, ch 778).

allocable to New York, there is no due process violation (*Mobil Oil Corporation v. Tax Commissioner*, 445 U.S. 425, *supra*).

As for equal protection, Westinghouse would have us hold that, since New York law provides that the income from all non-DISC subsidiaries is exempt from the State's franchise tax (Tax Law, § 208.9[a][1]), it is irrational to tax it on the deemed distribution income of its wholly-owned DISC subsidiary (Tax Law, § 208.8-A[b]). But, if the DISC had not elected to be treated as a domestic international sales corporation, the intercompany transactions in which it engaged would have compelled the Commission to require it and Westinghouse to file a combined report (see Tax Law, § 211 [4]). In the event, the allocated income of the DISC would be combined with the allocated income of Westinghouse (*see Matter of Wurlitzer Co. v. State Tax Commn.*, 35 N.Y.2d 100). As the Appellate Division correctly observed, "[t]here is nothing in the record to indicate that petitioner's tax liability resulting from a combined report . . . would be less than that which was in fact imposed" (82 A.D.2d 988, 989).

For all these reasons, the judgment of the Appellate Division should be modified by reinstating the determination of the State Tax Commission.

Chief Judge COOKE and Judges JASEN, GABRIELLI, JONES, WACHTLER and MEYER concur.

Judgment modified, with costs to the State Tax Commission, in accordance with the opinion herein and, as so modified, affirmed.

ORDER OF THE APPELLATE DIVISION

At a Term of the Appellate Division of the Supreme Court of the State of New York, held in and for the Third Judicial Department in the City of Albany, New York, commencing on the 20th day of April 1981.

PRESENT:

Hon. A. FRANKLIN MAHONEY,
Presiding Justice,

Hon. ROBERT G. MAIN,
Hon. ANN T. MIKOLL,
Hon. PAUL J. YESAWICH, JR.,
Hon. J. CLARENCE HERLIHY,
Associate Justices.

In the Matter of the Application of
WESTINGHOUSE ELECTRIC CORPORATION,
Petitioner,

For a Judgment Pursuant to Article 78 of the Civil Practice Law and Rules

v.

JAMES H. TULLY JR., MILTON KOERNER and THOMAS H. LYNCH, as the Tax Commission of the State of New York,
Respondents.

Albany County Clerk's Index No. 11313/79

Order of Annullment

The above-named petitioner, having instituted this proceeding in the Supreme Court, Albany County, pursuant to Article 78 of the Civil Practice Law and Rules, to review a determination of respondents, dated August 31, 1979, which sustained the imposition of corporate franchise tax assessments

imposed pursuant to Article 9-A of the Tax Law and said proceeding having been transferred for disposition to the Appellate Division, Third Department, by order of the Supreme Court, Albany County, dated and entered on January 25, 1980, and having been presented during the above-stated Term of this Court, and having been argued by Cravath, Swaine & Moore (Henry W. de Kosmian, of counsel), for petitioner, and by Robert Abrams, Attorney General of the State of New York (Francis V. Dow, Assistant Attorney General, of counsel), for respondents, and after due deliberation the Court having rendered a decision on the 18th day of June, 1981, Mahoney, Presiding Justice and Herlihy, Justice, dissenting, it is hereby

ORDERED, that the determination be and the same hereby is annulled, with costs, and the matter is remitted to the respondent Tax Commission of the State of New York for further proceedings not inconsistent with the June 18, 1981, decision of this Court.

ENTER:

JOHN J. O'BRIEN
Clerk

DATED AND ENTERED: June 29, 1981.

A TRUE COPY
/s/ JOHN J. O'BRIEN
Clerk

DECISION OF THE APPELLATE DIVISION, SUPREME COURT OF THE STATE OF NEW YORK, THIRD JUDICIAL DEPARTMENT

June 18, 1981 No. 39582

In the Matter of WESTINGHOUSE ELECTRIC CORPORATION,
Petitioner,

v.

JAMES H. TULLY, JR., et al., Constituting the Tax Commission of the State of New York,
Respondents.

Proceeding pursuant to CPLR article 78 (transferred to this court by order of the Supreme Court at Special Term, entered in Albany County) to review a determination of the State Tax Commission, which sustained corporate franchise tax assessments imposed pursuant to article 9-A of the Tax Law.

The principal issue presented is whether section 208 (subd. 9, par. [i], subpar. [B]) of the Tax Law is unconstitutional insofar as it purports to tax the accumulated income of a domestic international sales corporation (DISC), an entity which is the beneficiary of certain tax advantages under the Internal Revenue Code. A related issue concerns the obligation of a corporation doing business in New York, which is a shareholder of a DISC, when calculating its own income for state franchise tax purposes, to include income deemed to have been distributed to it by the DISC. The facts have been stipulated.

Petitioner, Westinghouse Electric Corporation (Westinghouse), a Pennsylvania corporation, does business in New York. It owns all of the stock of Westinghouse Electric Export Corporation (Westinghouse DISC), a Delaware corporation,

which acted as a commission agent for Westinghouse and affiliated companies, and which in 1972 and 1973 had qualified for DISC status under the Internal Revenue Code (U.S. Code tit. 26 § 991 *et seq.*). Westinghouse DISC's business income consisted entirely of commissions derived from export sales of products and related services made on behalf of Westinghouse and affiliated companies. Throughout this period it did not engage in any business activities in New York.

Under the provisions of the Internal Revenue Code, Westinghouse DISC itself was exempt from Federal income tax liability. However, a portion of its earnings and profits was "deemed distributed" to its shareholder (Westinghouse), whether or not it was actually distributed, and was directly taxable to the latter as a dividend (U.S. Code, tit. 26, § 995, subd. [b]). Federal taxation of the remainder of Westinghouse DISC's income, characterized as "accumulated income", was deferred. When Westinghouse filed its New York corporation franchise tax returns for these years, it included the deemed distributions from Westinghouse DISC in its net income, but not any portion of the DISC's accumulated income.

The State Department of Taxation and Finance charged that deficiencies existed in the amount of franchise tax due from Westinghouse. Specifically, the department, relying on section 208 (subd. 9, par. [i], subpar. [B]) of the Tax Law, maintained that in arriving at its franchise tax Westinghouse should have combined all of Westinghouse DISC's income and expenses with its own, other than transactions between the two companies. Except for correcting an arithmetic error, respondents rejected Westinghouse's petition challenging the deficiencies and this proceeding followed.

We determined that section 208 (subd. 9, par. [i], subpar. [B]) of the Tax Law, to the extent it requires Westinghouse DISC's accumulated income be added to petitioner's income, is unconstitutional, for it settles an impermissible burden on foreign commerce (U.S. Const., art. I, § 8, cl. [3]).

Enacted in 1971, sections 991 through 997 of the Internal Revenue Code created DISCs, a new class of corporation.

These corporations, receiving special tax treatment, derive substantially all of their income from export sales of properties manufactured in the United States, including commissions attributable to such sales. The essential purpose behind enactment of the DISC provisions was to encourage exportation to foreign countries of American made products so as to alleviate a burgeoning deficit in the United States balance of payments (*Caterpillar Tractor Co. v. United States*, 589 F.2d 1040). A correlative concern, expressed by the Senate Finance Committee, was to remove a competitive disadvantage experienced by domestic corporations engaged in export activities (S. Rep. No. 92-437, 92nd Cong., 1st Sess. 90 [1971] reprinted in [1971] U.S. Code Cong. & Admin. News, pp. 1918, 1996). The DISC provisions of the Code being unmistakably aimed at improving foreign commerce, any state impediment hindering that congressional intent is not constitutionally allowable.

In the calculation of the New York State franchise tax, section 208 (subd. 9, par. [i], subpar. [B]) of the Tax Law directs that a DISC's shareholder's attributable share of each receipt and expense of the DISC be added to the shareholder's income. Since that requires Westinghouse DISC's accumulated income be added to Westinghouse's entire net income, to be taxed thereon, it in effect imposes a tax on Westinghouse DISC's accumulated income, contrary to the congressionally established policy that such income currently be treated as tax exempt. By so computing petitioner's franchise tax, respondents encumber Congress's purpose in creating DISCs, for they diminish the tax advantage Congress bestowed on United States corporations engaged in foreign export trade. Although the Code's DISC provisions do not explicitly prohibit states from directly or indirectly taxing accumulated income, given their purpose it would be incongruous to suggest such a prohibition was not intended. As the State's statute infringes on Congress's power to regulate commerce, it necessarily must fall (*see Boston Stock Exchange v. State Tax Comm.*, 429 U.S. 318; *McGoldrick v. Gulf Oil Corp.*, 309 U.S. 414).

Petitioner also maintains that the inclusion of Westinghouse DISC's deemed distributions in Westinghouse's in-

come is invalid on equal protection and due process grounds. Neither claim is convincing.

With regard to its equal protection argument, Westinghouse urges that since dividends from subsidiaries, in general, are not subject to New York franchise tax, respondents have discriminated against it by requiring petitioner to include in its net income deemed distributions from Westinghouse DISC. There is nothing in the record to indicate that petitioner's tax liability resulting from a combined report, which in view of the extensive intercompany transactions could have been required here if Westinghouse DISC had been considered merely as a subsidiary (Tax Law, § 211, subd. 4; *Matter of Wurlitzer Co. v. State Tax Comm.*, 35 N.Y.2d 100), would be less than that which was in fact imposed.

As for the due process argument, Westinghouse maintains Westinghouse DISC neither engaged in business in New York nor participated in any other activities sufficient to justify a jurisdictional nexus and that, therefore, inclusion of the DISC's deemed distributions was improper. But where, as here, the activities of the parent and subsidiary are so interrelated as to constitute a single unitary business, separate geographical accounting is not required for purposes of state taxation and a reasonable apportionment formula fairly representing the amount of business apportioned to the state may be utilized (*Mobil Oil Corp. v. Comr. of Taxes*, 445 U.S. 425).

Determination annulled, with costs, and matter remitted to the State Tax Commission for further proceedings not inconsistent herewith.

MAIN, MIKOLL and YESAWICH, JR., JJ., concur; MAHONEY, P. J., and HERLIHY, J., dissent and vote to confirm in the following memorandum by HERLIHY, J. HERLIHY, J. (dissenting).

We join in the majority opinion as to the conclusion that the tax at issue herein does not violate the requirements of due process or equal protection.

However, while petitioner's view of the Federal treatment of income derived from domestic corporations engaged in export activities as regulating foreign commerce has some merit, the fact remains that the Internal Revenue Code does not exempt the income from taxation. The tax imposed herein is based upon the taxpayer's relationship to the wholly-owned subsidiary and is unrelated to the subsidiary's function of overseas sales—foreign commerce.

Petitioner has failed to demonstrate any tax imposed on foreign commerce or any implicit prohibition on the power of the State to allocate net income to the shareholder as a portion of income subject to the New York State franchise tax. Upon the present record, the inference that the Internal Revenue Code is an exclusive regulation of foreign commerce is speculative and does not suffice to overcome the presumption of the constitutionality of the New York statute.

The determination of the Tax Commission should be confirmed, and the petition dismissed.

ORDER OF THE NEW YORK SUPREME COURT

AT a Special Term of the Supreme Court of the State of New York, held in and for the County of Albany, at the Courthouse, in the City of Albany, New York, on the 25th day of January, 1980.

PRESENT:

Hon. EDWARD S. CONWAY,
Justice.

In the Matter of the Application of
WESTINGHOUSE ELECTRIC CORPORATION,
Petitioner,

For a Judgment Pursuant to Article 78 of the Civil Practice Law and Rules
—against—

JAMES H. TULLY, JR., MILTON KOERNER and THOMAS H. LYNCH, as the Tax Commission of the State of New York,
Respondents.

ORDER
Index No. 11313-79

Upon reading and filing the notice of petition and petition of Westinghouse Electric Corporation, verified the 18th day of December, 1979, and the answer and return of the respondents, verified the 10th day of January, 1980, and it appearing that one of the issues involved is whether the determination of the respondents made as a result of a hearing and at which evidence was taken pursuant to direction by law is, on the entire record, supported by substantial evidence, and due deliberation having been had,

NOW, upon motion of Robert Abrams, Attorney General of the State of New York, attorney for respondents, it is

ORDERED, that pursuant to section 7804(g) of the Civil Practice Law and Rules, the above-entitled proceeding be and the same hereby is transferred to the Appellate Division of the Supreme Court, Third Judicial Department, for disposition.

Dated: Albany, New York
January 25, 1980

/s/ EDWARD S. CONWAY
J.S.C.

ENTER:

DECISION OF THE STATE TAX COMMISSION

STATE OF NEW YORK STATE TAX COMMISSION

In the Matter of the Petition

of

WESTINGHOUSE ELECTRIC CORPORATION

for Redetermination of a Deficiency or for Refund of Franchise Tax on a Business Corporation under Article 9-A of the Tax Law for the Years 1972 and 1973.

DECISION

Petitioner, Westinghouse Electric Corporation, Gateway Center, Pittsburgh, Pennsylvania 15225, filed a petition for redetermination of a deficiency or for refund of franchise tax on a business corporation under Article 9-A of the Tax Law for the years 1972 and 1973 (File No. 17433).

A formal hearing was held before Julius E. Braun, Hearing Officer, at the offices of the State Tax Commission, Two World Trade Center, New York, New York, on January 18, 1978 at 1:15 P.M. Petitioner appeared by Cravath, Swaine and Moore, Esqs. (Henry W. DeKosmian, Esq. and Patricia Geoghegan, Esq., of counsel). The Corporation Tax Bureau appeared by Peter Crotty, Esq. (James Morris, Esq., of counsel).

ISSUE

Whether section 208.9(i)(B) of the Tax Law which required petitioner to consolidate the receipts, expenses, assets and liabilities of its wholly owned subsidiary, Westinghouse Electric Export Corporation (a "DISC" corporation), with its own, in computing its New York income tax liability, is constitutional.

FINDINGS OF FACT

1. On June 15, 1976 pursuant to a field audit, the Corporation Tax Bureau issued a Statement of Audit Adjustment to petitioner, Westinghouse Electric Corporation, for the periods ending December 31, 1972 and December 31, 1973, assessing additional tax. Accordingly, a Notice of Deficiency was issued on the same day for $73,970.23, plus interest of $18,026.55, for a total of $91,996.78, for the period ending December 31, 1972, and $151,436.76, plus interest of $25,547.38, for a total of $176,984.14 for the period ending December 31, 1973. Due to the transposition of numbers by the auditor, the tax due should be $71,970.00, plus interest, for the period ending December 31, 1972.

2. Petitioner, Westinghouse Electric Corporation, and the Corporation Tax Bureau stipulated and agreed as follows:

a. Petitioner, Westinghouse Electric Corporation ("Westinghouse"), is a Pennsylvania corporation which does business in New York State.

b. Westinghouse Electric Export Corporation ("DISC") is a Delaware corporation which elected to be treated as a domestic international sales organization for Federal income tax purposes and was so treated for the years 1972 and 1973.

c. Westinghouse owns all the stock of DISC.

d. Westinghouse and DISC keep their records on the accrual method of accounting.

e. During 1972 and 1973, DISC qualified under Section 992(a) of the Internal Revenue Code of 1954 (the "Code") and was exempt from Federal income tax for such years under Section 991 of the Code.

f. DISC was commission agent for Westinghouse and affiliated companies in respect of export sales of property and related services. All of DISC's business income for 1972 and 1973 consisted of commissions paid it in respect of

export sales of products and related services by Westinghouse and other affiliated companies.

g. DISC reported total income on Federal Form 1120-DISC for 1972 and 1973 in the amounts of $25,987,000 and $57,948,738, respectively. Of DISC's total 1972 income, $19,888,000 was received from Westinghouse and $6,099,000 was received from other affiliated companies not doing business in New York State.

h. DISC did not make any distributions to Westinghouse in 1972. DISC distributed $10,068,500 to Westinghouse in 1973, all of which was treated as made out of previously taxed income under Section 996(a)(1) of the Code.

i. $12,956,500 of DISC's total income for 1972 and $29,838,006 of its taxable income for 1973 was deemed distributed by DISC to Westinghouse in 1972 and 1973, respectively, under Section 995(b) of the Code and Westinghouse included those amounts in its Federal gross income for 1972 and 1973. Federal taxation of the remainder of DISC's total income for 1972 and 1973 (the "accumulated DISC income") was deferred under the DISC provisions of the Code.

j. During 1972 and 1973, DISC had no paid employees, did not engage in any business activities in New York, nor did it employ capital, own or lease real or tangible personal property, pay real estate rentals, or maintain an office in New York State at any time during such years.

k. DISC did not file a New York corporate franchise tax return for either 1972 or 1973 because it and Westinghouse take the position that DISC was not subject to New York jurisdiction.

l. Westinghouse filed Form CT-3 with the State of New York for 1972 and 1973 as a Pennsylvania corporation doing business in New York. Its reported entire net income for 1972 and 1973 was $136,516,711 and

$43,715,850, respectively, which included the $12,956,500 and $29,838,006 deemed distributions from DISC for those years but did not include any portion of DISC's accumulated DISC income for such years. The deemed distributions were allocated to New York according to Westinghouse's business allocation percentages of 6.387743% for 1972 and 6.239516% for 1973, computed without regard to such deemed distributions.

m. In separate Notices of Deficiency dated June 15, 1976, the Corporation Tax Bureau of the Department of Taxation and Finance alleged deficiencies in Westinghouse's corporate franchise tax of $73,970.23 for 1972 and $151,436.76 for 1973.

n. The entire amount of the alleged deficiencies relates to Westinghouse's treatment of the total income of DISC for 1972 and 1973 on Westinghouse's own returns.

o. The alleged deficiencies were computed as follows:

(1) Because more than 5% of DISC's gross receipts in both 1972 and 1973 consisted of sales commissions from Westinghouse, DISC would have been exempt from New York franchise tax under Section 208.9(i)(A) of Chapter 60, Article 9-A of the New York Tax Law whether or not New York otherwise had jurisdiction to subject it to tax. It is therefore alleged in the Notices of Deficiency that Westinghouse is required under Section 208.9(i)(B) of the Tax Law to consolidate DISC's receipts, expenses, assets and liabilities with its own in computing its New York income tax liability, excluding all transactions between Westinghouse and DISC.

(2) Since Westinghouse only included the deemed distributions from DISC for 1972 and 1973, and not the DISC's accumulated DISC income for such years, in its own entire net income for 1972 and 1973, it is proposed in the Notices of Deficiency that

Westinghouse's entire net income for 1972 be increased by $13,390,500 from $136,516,711 to $149,907,211 and that its entire net income for 1973 be increased by $28,110,732 from $43,715,850 to $71,826,582. In addition, it is proposed in the Notices of Deficiency that the receipts factors used to compute Westinghouse's business allocation percentages for 1972 and 1973 be recomputed by adding DISC's commission income derived from customers other than Westinghouse (which other customers did not do business in New York and were not subject to New York tax) for such years to the denominator of such factors, but not to the numerator, thus reducing Westinghouse's receipts factor for 1972 from 5.945712% as reported on its 1972 return, to 5.935845% and reducing its receipts factor for 1973 from 5.665182%, as reported on its 1973 return, to 5.650114%. Such a calculation results in a reduction of Westinghouse's business allocation percentage for 1972 from 6.387743% to 6.384454% and for 1973 from 6.239516% to 6.234494%. The net effect of the two proposed adjustments for 1972 described above increased Westinghouse's business income for 1972 allocable to New York from $8,683,334 to $9,533,778, an increase of $580,444, with a resulting deficiency in tax for 1972 of $76,539.96. Similarly, the net effect of the two proposed adjustments for 1973 described above increased Westinghouse's business income for 1973 allocable to New York from $2,702,912 to $4,453,304, an increase of $1,750,392, with a resulting deficiency in tax for 1973 of $157,535.28.

(3) It is proposed in the Notice of Deficiency, however, that Westinghouse be allowed credits under Section 210(13)(a) of the Tax Law in the respective amounts of $2,569.77 and $6,098.22 for 1972 and 1973. Such credits were computed by first multiplying $13,390,500, and $28,110,732, representing the DISC's accumulated DISC income for 1972 and 1973

respectively, as computed by the auditor, by 4.771297% and 5.523182%, respectively, those being the percentages of Westinghouse's receipts from export property on which DISC earned a sales commission and which was shipped from a regular place of business of Westinghouse in New York as compared to Westinghouse's total receipts on the sale of export property for such years for which DISC received a sales commission. Such total receipts amounted to $223,587,000 in 1972 and $408,080,000 in 1973.

(4) The respective products, $638,901 for 1972 and $1,552,607 for 1973, were then multiplied by Westinghouse's revised business allocation percentages for the respective years, with the result that of the $13,390,500 and $28,110,732 alleged to be includable in Westinghouse's entire net income for 1972 and 1973, respectively, only $40,790 and $96,797 respectively, was found to be eligible for credit under Section 210(13)(a). These amounts were then multiplied first by 70% and then by the 9% rate of tax in effect for 1972 and 1973 to arrive at credits of $2,569.77 and $6,098.22 for 1972 and 1973, respectively.

p. Westinghouse paid franchise tax under Article 9-A of the Tax Law in the amounts of $749,384 and $205,548, respectively, for 1972 and 1973. The taxes so paid by Westinghouse reflected the inclusion in its business income for 1972 and 1973 of the deemed distributions in the amounts of $12,956,500 and $29,838,006 for 1972 and 1973, respectively.

q. With respect to Westinghouse's assignment of error number 2 of the Perfected Petition, the Department of Taxation and Finance for the State of New York concedes that the proposed increase in Westinghouse's entire net income for 1972 under the State's theory should be $13,030,500 rather than $13,390,500 and that therefore the proposed deficiency for 1972 is $71,970.

r. The parties agree to reserve the calculation of the amount of any deficiency or refund until ultimate resolution of the issues raised in Westinghouse's petition.

s. The petition in this action was timely filed on September 10, 1976.

CONCLUSIONS OF LAW

A. That the constitutionality of the laws of the State of New York is presumed at the administrative level. Accordingly, the State Tax Commission does not have jurisdiction to declare such laws unconstitutional and it must be presumed that section 208.9(i)(B) of the Tax Law is constitutional to the extent that it relates to the imposition of the tax which is the subject of this proceeding.

B. That the petition of Westinghouse Electric Corporation is denied and the notices of deficiency issued June 15, 1976, are sustained.

DATED: Albany, New York
August 31, 1979

STATE TAX COMMISSION

/s/ JAMES H. TULLY, JR.
President

/s/ MILTON KOERNER
Commissioner

/s/ THOMAS H. LYNCH
Commissioner

ORDER OF THE COURT OF APPEALS

COURT OF APPEALS
STATE OF NEW YORK
The Hon. Lawrence H. Cooke, Chief Judge, Presiding

3	No. 97
In the Matter of WESTINGHOUSE ELECTRIC CORPORATION, *Respondent-Appellant,*	
v.	
JAMES H. TULLY, JR., & ors., as the Tax Commission of the State of New York, *Appellants-Respondents.*	

The appellant(s)-respondents in the above entitled appeal appeared by Robert Abrams, Attorney General;

The respondent(s)-appellant appeared by Cravath, Swaine & Moore.

The Court, after due deliberation, orders and adjudges that the judgment is modified, with costs to the State Tax Commission, in accordance with the opinion herein and, as so modified, affirmed. Opinion by Judge Fuchsberg. Chief Judge Cooke and Judges Jasen, Gabrielli, Jones, Wachtler and Meyer concur.

The Court further orders that the papers required to be filed and this record of the proceedings in this Court be remitted to the Supreme Court, Albany County, there to be proceeded upon according to law.

I certify that the preceding contains a correct record of the proceedings in this appeal in the Court of Appeals and that the papers required to be filed are attached.

JOSEPH W. BELLACOSA

Joseph W. Bellacosa,
Clerk of the Court

Court of Appeals, Clerk's Office, Albany, April 1, 1982.

NOTICE OF APPEAL

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF ALBANY

In the Matter of the Application of
WESTINGHOUSE ELECTRIC CORPORATION,
Petitioner,

For a Judgment Pursuant to Article 78 of the Civil Practice Law and Rules

—against—

JAMES H. TULLY, JR., MILTON KOERNER and THOMAS H. LYNCH, as the Tax Commission of the State of New York,
Respondents.

Index No. 11313/1979

Notice of Appeal to the Supreme Court of the United States

NOTICE is hereby given that Westinghouse Electric Corporation, the petitioner above-named, hereby appeals to the Supreme Court of the United States from each and every part of the final decision of the Court of Appeals of the State of New York filed April 1, 1982, modifying the judgment of the Appellate Division of the Supreme Court of the State of New York entered on June 29, 1981, by reinstating the determination of respondents.

This appeal is taken pursuant to 28 U.S.C. § 1257(2).

June 28, 1982.

CRAVATH, SWAINE & MOORE,
Attorneys for Petitioner,
One Chase Manhattan Plaza,
New York, N. Y. 10005
(212) 422-3000

To:

HON. ROBERT ABRAMS,
Attorney General of
the State of New York,
Attorney for Respondents,
The Capitol,
Albany, New York 12224

CLERK,
Supreme Court, Albany County,
Court House,
Albany, New York 12207.

Office of
Albany County Clerk
Albany, N.Y.
Jun. 28,
12:39 p.m. '82

CLERK,
Court of Appeals,
State of New York,
20 Eagle St.,
Albany, New York 12207.

RECEIVED
Jun. 28, 1982
COURT OF APPEALS

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

UNITED STATES CONSTITUTION

Article I, Section 8

The Congress shall have Power . . .

[3] To regulate Commerce with foreign Nations, and among the several States and with the Indian Tribes.

Article VI

[2] This Constitution and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

Amendment 14, Section 1

All persons born or naturalized in the United States, and subject to the jurisdiction thereof, are citizens of the United States and of the States wherein they reside. No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States, nor shall any State deprive any person of life, liberty or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.

INTERNAL REVENUE CODE OF 1954, AS AMENDED
(as in effect in 1972 and 1973)

PART IV—DOMESTIC INTERNATIONAL SALES CORPORATION

A. Treatment of qualifying corporations.

B. Treatment of distributions to shareholders.

SUBPART A—TREATMENT OF QUALIFYING CORPORATIONS

§ 991. Taxation of a domestic international sales corporation.

§ 992. Requirements of a domestic international sales corporation.

§ 993. Definitions and special rules.

§ 994. Inter-company pricing rules.

§ 991. ***Taxation of a Domestic International Sales Corporation***

For purposes of the taxes imposed by this subtitle upon a DISC (as defined in section 992(a)), a DISC shall not be subject to the taxes imposed by this subtitle except for the tax imposed by chapter 5.

§ 992. ***Requirements of a Domestic International Sales Corporation***

(a) **Definition of "DISC" and "former DISC".**

(1) **DISC.**—For purposes of this title, the term "DISC" means, with respect to any taxable year, a corporation which is incorporated under the laws of any State and satisfies the following conditions for the taxable year:

(A) 95 percent or more of the gross receipts (as defined in section 993(f)) of such corporation consist of qualified export receipts (as defined in section 993(a)),

(B) the adjusted basis of the qualified export assets (as defined in section 993(b)) of the corpo-

ration at the close of the taxable year equals or exceeds 95 percent of the sum of the adjusted basis of all assets of the corporation at the close of the taxable year,

(C) such corporation does not have more than one class of stock and the par or stated value of its outstanding stock is at least $2,500 on each day of the taxable year; and

(D) the corporation has made an election pursuant to subsection (b) to be treated as a DISC and such election is in effect for the taxable year.

(2) **Status as DISC after having filed a return as a DISC.**—The Secretary or his delegate shall prescribe regulations setting forth the conditions under and the extent to which a corporation which has filed a return as a DISC for a taxable year shall be treated as a DISC for such taxable year for all purposes of this title, notwithstanding the fact that the corporation has failed to satisfy the conditions of paragraph (1).

(3) **"Former DISC".**—For purposes of this title, the term "former DISC" means, with respect to any taxable year, a corporation which is not a DISC for such year but was a DISC in a preceding taxable year and at the beginning of the taxable year has undistributed previously taxed income or accumulated DISC income.

(b) Election.

(1) Election.

(A) An election by a corporation to be treated as a DISC shall be made by such corporation for a taxable year at any time during the 90-day period immediately preceding the beginning of the taxable year, except that the Secretary or his delegate may give his consent to the making of an election at such other times as he may designate.

(B) Such election shall be made in such manner as the Secretary or his delegate shall prescribe and shall be valid only if all persons who are shareholders in such corporation on the first day of the first taxable year for which such election is effective consent to such election.

(2) Effect of election.—If a corporation makes an election under paragraph (1), then the provisions of this part shall apply to such corporation for the taxable year of the corporation for which made and for all succeeding taxable years and shall apply to each person who at any time is a shareholder of such corporation for all periods on or after the first day of the first taxable year of the corporation for which the election is effective.

(3) Termination of election.

(A) Revocation.—An election under this subsection made by any corporation may be terminated by revocation of such election for any taxable year of the corporation after the first taxable year of the corporation for which the election is effective. A termination under this paragraph shall be effective with respect to such election

(i) for the taxable year in which made, if made at any time during the first 90 days of such taxable year, or

(ii) for the taxable year following the taxable year in which made, if made after the close of such 90 days,

and for all succeeding taxable years of the corporation. Such termination shall be made in such manner as the Secretary or his delegate shall prescribe by regulations.

(B) Continued failure to be DISC.—If a corporation is not a DISC for each of any 5 consecutive

taxable years of the corporation for which an election under this subsection is effective, the election shall be terminated and not be in effect for any taxable year of the corporation after such 5th year.

(c) Distributions to meet qualification requirements.

(1) In general. Subject to the conditions provided by paragraph (2), a corporation which for a taxable year does not satisfy a condition specified in paragraph (1)(A) (relating to gross receipts) or (1)(B) (relating to assets) of subsection (a) shall nevertheless be deemed to satisfy such condition for such year if it makes a pro rata distribution of property after the close of the taxable year to its shareholders (designated at the time of such distribution as a distribution to meet qualification requirements) with respect to their stock in an amount which is equal to

(A) if the condition of subsection (a)(1)(A) is not satisfied, the portion of such corporation's taxable income attributable to its gross receipts which are not qualified export receipts for such year,

(B) if the condition of subsection (a)(1)(B) is not satisfied, the fair market value of those assets which are not qualified export assets on the last day of such taxable year, or

(C) if neither of such conditions is satisfied, the sum of the amounts required by subparagraphs (A) and (B).

(2) Reasonable cause for failure.—The conditions under paragraph (1) shall be deemed satisfied in the case of a distribution made under such paragraph

(A) if the failure to meet the requirements of subsection (a)(1)(A) or (B), and the failure to make such distribution prior to the date on which made, are due to reasonable cause; and

(B) the corporation pays, within the 30-day period beginning with the day on which such distribution is made, to the Secretary or his delegate, if such corporation makes such distribution after the 15th day of the 9th month after the close of the taxable year, an amount determined by multiplying (i) the amount equal to 4½ percent of such distribution, by (ii) the number of its taxable years which begin after the taxable year with respect to which such distribution is made and before such distribution is made. For purposes of this title, any payment made pursuant to this paragraph shall be treated as interest.

(3) Certain distributions made within 8½ months after close of taxable year deemed for reasonable cause.—A distribution made on or before the 15th day of the 9th month after the close of the taxable year shall be deemed for reasonable cause for purposes of paragraph (2)(A) if—

(A) at least 70 percent of the gross receipts of such corporation for such taxable year consist of qualified export receipts, and

(B) the adjusted basis of the qualified export assets held by the corporation on the last day of each month of the taxable year equals or exceeds 70 percent of the sum of the adjusted basis of all assets held by the corporation on such day.

(d) **Ineligible corporations.**—The following corporations shall not be eligible to be treated as a DISC—

(1) a corporation exempt from tax by reason of section 501,

(2) a personal holding company (as defined in section 542),

(3) a financial institution to which section 581 or 593 applies,

(4) an insurance company subject to the tax imposed by subchapter L,

(5) a regulated investment company (as defined in section 851(a)

(6) a China Trade Act corporation receiving the special deduction provided in section 941(a), or

(7) an electing small business corporation (as defined in section 1371(b).

(e) Coordination with personal holding company provisions in case of certain produced film rents—If—

(1) a corporation (hereinafter in this subsection referred to as "subsidiary") was established to take advantage of the provisions of this part, and

(2) a second corporation (hereinafter in this subsection referred to as "parent") throughout the taxable year owns directly at least 80 percent of the stock of the subsidiary;

then, for purposes of applying subsection (d)(2) and section 541 (relating to personal holding company tax) to the subsidiary for the taxable year, there shall be taken into account under section 543(a)(5) (relating to produced film rents) any interest in a film acquired by the parent and transferred to the subsidiary as if such interest were acquired by the subsidiary at the time it was acquired by the parent.

§ 993. ***Definitions***

(a) **Qualified export receipts—**

(1) **General rule.**—For purposes of this part, except as provided by regulations under paragraph (2), the qualified export receipts of a corporation are—

(A) gross receipts from the sale, exchange, or other disposition of esport property,

(B) gross receipts from the lease or rental of export property, which is used by the lessee of such property outside the United States,

(C) gross receipts for services which are related and subsidiary to any qualified sale, exchange, lease, rental, or other disposition of export property by such corporation,

(D) gross receipts from the sale, exchange, or other disposition of qualified export assets (other than export property),

(E) dividends (or amounts includible in gross income under section 951) with respect to stock of a related foreign export corporation (as defined in subsection (e)

(F) interest on any obligation which is a qu.. .- fied export asset,

(G) gross receipts for engineering or architectural services for construction projects located (or proposed for location) outside the United States, and

(H) gross receipts for the performance or managerial services in furtherance of the production of other qualified export receipts of a DISC.

(2) **Excluded receipts.**—The Secretary or his delegate may under regulations designate receipts from the sale, exchange, lease, rental, or other disposition of export property, and from services, as not being receipts described in paragraph (1) if he determines that such sale, exchange, lease, rental, or other disposition, or furnishing of services—

(A) is for ultimate use in the United States;

(B) is accomplished by a subsidy granted by the United States or any instrumentality thereof;

(C) is for use by the United States or any instrumentality thereof where the use of such export property or services is required by law or regulation.

For purposes of this part, the term "qualified export receipts" does not include receipts from a corporation which is a DISC for its taxable year in which the receipts arise and which is a member of a controlled group (as defined in paragraph (3) which includes the recipient corporation.

(3) **Definition of controlled group.**—For purposes of this part, the term "controlled group" has the meaning assigned to such term by section 1563(a), except that the phrase "more than 50 percent" shall be substituted for the phrase "at least 80 percent" each place it appears therein, and section 1563(b) shall not apply.

(b) **Qualified export assets.**—For purposes of this part, the qualified export assets of a corporation are—

(1) export property (as defined in subsection (c);

(2) assets used primarily in connection with the sale, lease, rental, storage, handling, transportation, packaging, assembly, or servicing of export property, or the performance of engineering or architectural services described in subparagraph (G) of subsection (a)(1) or managerial services in furtherance of the production of qualified export receipts described in subparagraphs (A), (B), (C), and (G) of subsection (a)(1);

(3) accounts receivable and evidences of indebtedness which arise by reason of transactions of such corporation described in subparagraphs (A), (B), (C), (G), or (H), of subsection (a)(1);

(4) money, bank deposits, and other similar temporary investments, which are reasonably necessary to meet the working capital requirements of such corporation;

(5) obligations arising in connection with a producer's loan (as defined in subsection (d);

(6) stock or securities of a related foreign export corporation (as defined in subsection (e);

(7) obligations issued, guaranteed, or insured, in whole or in part, by the Export-Import Bank of the United States or the Foreign Credit Insurance Association in those cases where such obligations are required from such Bank or Association or from the seller or purchaser of the goods or services with respect to which such obligations arose;

(8) obligations issued by a domestic corporation organized solely for the purpose of financing sales of export property pursuant to an agreement with the Export-Import Bank of the United States under which such corporation makes export loans guaranteed by such bank; and

(9) amounts (other than reasonable working capital) on deposit in the United States that are utilized during the period provided for in, and otherwise in accordance with, regulations prescribed by the Secretary or his delegate to acquire other qualified export assets.

(c) **Export property**—

(1) **In general.**—For purposes of this part, the term "export property" means property

(A) manufactured, produced, grown, or extracted in the United States by a person other than a DISC.

(B) held primarily for sale, lease, or rental, in the ordinary course of trade or business by, or to, a DISC, for direct use, consumption, or disposition outside the United States, and

(C) not more than 50 percent of the fair market value of which is attributable to articles imported into the United States.

In applying subparagraph (C), the fair market value of any article imported into the United States shall be its

appraised value, as determined by the Secretary or his delegate under section 402 or 402a of the Tariff Act of 1930 (19 U.S.C., Sec. 1401a or 1402) in connection with its importation.

(2) **Excluded property.**—For purposes of this part, the term "export property" does not include—

(A) property leased or rented by a DISC for use by any member of a controlled group (as defined in subsection (a)(3) which includes the DISC, or

(B) patents, inventions, models, designs, formulas, or processes, whether or not patented, copyrights (other than films, tapes, records, or similar reproductions, for commercial or home use), good will, trademarks, trade brands, franchises, or other like property.

(3) **Property in short supply.**—If the President determines that the supply of any property described in paragraph (1) is insufficient to meet the requirements of the domestic economy, he may by Executive order designate the property as in short supply. Any property so designated shall be treated as property not described in paragraph (1) during the period beginning with the date specified in the Executive order and ending with the date specified in an Executive order setting forth the President's determination that the property is no longer in short supply.

(d) **Producer's loans.**—

(1) **In general.**—An obligation, subject to the rules provided in paragraphs (2) and (3), shall be treated as arising out of a producer's loan if—

(A) the loan, when added to the unpaid balance of all other producer's loans made by the DISC, does not exceed the accumulated DISC income at the beginning of the month in which the loan is made;

(B) the obligation is evidenced by a note (or other evidence of indebtedness) with a stated maturity date not more than 5 years from the date of the loan;

(C) the loan is made to a person engaged in the United States in the manufacturing, production, growing, or extraction of export property (referred to hereinafter as the "borrower"); and

(D) at the time of such loan it is designated as a producer's loan.

(2) **Limitation.**—An obligation shall be treated as arising out of a producer's loan only to the extent that such loan, when added to the unpaid balance of all other producer's loans to the borrower outstanding at the time such loan is made, does not exceed an amount determined by multiplying the sum of—

(A) the amount of the borrower's adjusted basis determined at the beginning of the borrower's taxable year in which the loan is made, in plant, machinery, and equipment, and supporting production facilities in the United States;

(B) the amount of the borrower's property held primarily for sale, lease, or rental, to customers in the ordinary course of trade or business, at the beginning of such taxable year; and

(C) the aggregate amount of the borrower's research and experimental expenditures (within the meaning of section 174) in the United States during all preceding taxable years beginning after December 31, 1971,

by the percentage which the borrower's receipts, during the 3 taxable years immediately preceding the taxable year (but not including any taxable year commencing prior to 1972) in which the loan is made, from the sale, lease, or rental outside the United States of property which would

be export property if held by a DISC is of the gross receipts during such 3 taxable years from the sale, lease, or rental of property held by such borrower primarily for sale, lease, or rental to customers in the ordinary course of the trade or business of such borrower.

(3) **Increased investment requirement.**—An obligation shall be treated as arising out of a producer's loan in a taxable year only to the extent that such loan, when added to the unpaid balance of all other producer's loans to the borrower made during such taxable year, does not exceed an amount equal to—

(A) the amount by which the sum of the adjusted basis of assets described in paragraph (2)(A) and (B) on the last day of the taxable year in which the loan is made exceeds the sum of the adjusted basis of such assets on the first day of such taxable year; plus

(B) the aggregate amount of the borrower's research and experimental expenditures (within the meaning of section 174) in the United States during such taxable year.

(4) **Special limitation in the case of domestic film maker.** . . .

(e) **Related foreign export corporation.**—In determining whether a corporation (hereinafter in this subsection referred to as "the domestic corporation") is a DISC—

(1) **Foreign international sales corporation.**—A foreign corporation is a related foreign export corporation if—

(A) stock possessing more than 50 percent of the total combined voting power of all classes of stock entitled to vote is owned directly by the domestic corporation,

(B) 95 percent or more of such foreign corporation's gross receipts for its taxable year ending with

or within the taxable year of the domestic corporation consists of qualified export receipts described in subparagraphs (A), (B), (C), and (D) of subsection (a)(1) and interest on any obligation described in paragraphs (3) and (4) of subsection (b), and

(C) the adjusted basis of the qualified export assets (described in paragraphs (1), (2), (3), and (4) of subsection (b)) held by such foreign corporation at the close of such taxable year equals or exceeds 95 percent of the sum of the adjusted basis of all assets held by it at the close of such taxable year.

(2) **Real property holding company.**—A foreign corporation is a related foreign export corporation if—

(A) stock possessing more than 50 percent of the total combined voting power of all classes of stock entitled to vote is owned directly by the domestic corporation, and

(B) its exclusive function is to hold real property for the exclusive use (under a lease or otherwise) of the domestic corporation.

(3) **Associated foreign corporation.**—A foreign corporation is a related foreign export corporation if—

(A) less than 10 percent of the total combined voting power of all classes of stock entitled to vote of such foreign corporation is owned (within the meaning of section 1563(d) and (e)) by the domestic corporation or by a controlled group of corporations (within the meaning of section 1563) of which the domestic corporation is a member, and

(B) the ownership of stock or securities in such foreign corporation by the domestic corporation is determined (under regulations prescribed by the Secretary or his delegate) to be reasonably in furtherance

of a transaction or transactions giving rise to qualified export receipts of the domestic corporation.

(f) **Gross receipts.**—For purposes of this part, the term "gross receipts" means the total receipts from the sale, lease, or rental of property held primarily for sale, lease, or rental in the ordinary course of trade or business, and gross income from all other sources. In the case of commissions on the sale, lease, or rental of property, the amount taken into account for purposes of this part as gross receipts shall be the gross receipts on the sale, lease, or rental of the property on which such commissions arose.

(g) **United States defined.**—For purposes of this part, the term "United States" includes the Commonwealth of Puerto Rico and the possessions of the United States.

§ 994. *Inter-Company Pricing Rules*

(a) **In general.**—In the case of a sale for export property to a DISC by a person described in Section 482, the taxable income of such DISC and such person shall be based upon a transfer price which would allow such DISC to derive taxable income attributable to such sale (regardless of the sales price actually charged) in an amount which does not exceed the greatest of—

(1) 4 percent of the qualified export receipts on the sale of such property by the DISC plus 10 percent of the export promotion expenses of such DISC attributable to such receipts,

(2) 50 percent of the combined taxable income of such DISC and such person which is attributable to the qualified export receipts on such property derived as the result of a sale by the DISC plus 10 percent of the export promotion expenses of such DISC attributable to such receipts, or

(3) taxable income based on the sale price actually charged (but subject to the rules provided in section 482).

(b) **Rules for commissions, rentals, and marginal costing.**—The Secretary or his delegate shall prescribe regulations setting forth—

(1) rules which are consistent with the rules set forth in subsection (a) for the application of this section in the case of commissions, rentals, and other income, and

(2) rules for the allocation of expenditures in computing combined taxable income under subsection (a)(2) in those cases where a DISC is seeking to establish or maintain a market for export property.

(c) **Export Promotion expenses.**—For purposes of this section, the term "export promotion expenses" means those expenses incurred to advance the distribution or sale of export property for use, consumption, or distribution outside of the United States, but does not include income taxes. Such expenses shall also include freight expenses to the extent of 50 percent of the cost of shipping export property aboard airplanes owned and operated by United States persons or ships documented under the laws of the United States in those cases where law or regulations does not require that such property be shipped aboard such airplanes or ships.

SUBPART B—TREATMENT OF DISTRIBUTIONS TO SHAREHOLDERS

§ 995. Taxation of DISC income to shareholders.

§ 996. Rules for allocation in the case of distributions and losses.

§ 997. Special subchapter C rules.

§ 995. ***Taxation of DISC Income to Shareholders.***

(a) **General rule.**—A shareholder of a DISC or former DISC shall be subject to taxation on the earnings and profits of a DISC as provided in this chapter, but subject to the modifications of this subpart.

(b) **Deemed distributions.**—

(1) **Distributions in qualified years.**—A shareholder of a DISC shall be treated as having received a distribution taxable as a dividend with respect to his stock in an amount which is equal to his pro rata share of the sum (or, if smaller, the earnings and profits for the taxable year) of—

(A) the gross interest derived during the taxable year from producer's loans,

(B) the gain recognized by the DISC during the taxable year on the sale or exchange of property, other than property which in the hands of the DISC is a qualified export asset, previously transferred to it in a transaction in which gain was not recognized in whole or in part, but onlv to the extent that the transferor's gain on the previous transfer was not recognized.

(C) the gain (other than the gain desribed in subparagraph (B)) recognized by the DISC during the taxable year on the sale or exchange of property (other than property which in the hands of the DISC is stock in trade or other property described in section 1221(1)) previously transferred to it in a transaction in which gain was not recognized in whole or in part but only to the extent that the transferor's gain on the previous transfer was not recognized and would have been treated as gain from the sale or exchange of property which is neither a capital asset nor property described in section 1231 if the property had been sold or exchanged rather than transferred to the DISC.

(D) one-half of the excess of the taxable income of the DISC for the taxable year, before reduction for any distributions during the year, over the sum of the amounts deemed distributed for the taxable year under subparagraphs (A), (B), and (C), and.

(E) the amount of foreign investment attributable to producer's loans (as defined in subsection (d) of a DISC for the taxable year.

Distributions described in this paragraph shall be deemed to be received on the last day of the taxable year of the DISC in which the gross income (taxable income in the case of subparagraph (D)) was derived. In the case of a distribution described in subparagraph (E), earnings and profits for the taxable year shall include accumulated earnings and profits.

(2) **Distributions upon disqualification.**—

(A) A shareholder of a corporation which revoked its election to be treated as a DISC or failed to satisfy the conditions of section 992(a)(1) for a taxable year shall be deemed to have received (at the time specified in subparagraph (B)) a distribution taxable as a dividend equal to his pro rata share of the DISC income of such corporation accumulated during the immediately preceding consecutive taxable years for which the corporation was a DISC.

(B) Distributions described in subparagraph (A) shall be deemed to be received in equal installments on the last day of each of the 10 taxable years of the corporation following the year of the termination or disqualification described in subparagraph (A)(but in no case over more than the number of immediately preceding consecutive taxable years during which the corporation was a DISC).

(c) **Gain on disposition of stock in a DISC.**—If a shareholder disposes of stock in a DISC or former DISC, any gain recognized on such disposition shall be included in gross income as a dividend to the extent of the accumulated DISC income of such DISC or former DISC which is attributable to such stock and which was accumulated in taxable years of such corporation during the period or periods the stock disposed of

was held by such shareholder. If stock of the DISC or former DISC is disposed of in a transaction in which the separate corporation existence of the DISC or former DISC is terminated other than by a mere change in place of organization, however effected, any gain realized on the disposition of such stock in the transaction shall be recognized notwithstanding any other provision of this title to the extent of the accumulated DISC income of such DISC or former DISC which is attributable to such stock and which was accumulated in taxable years of such corporation during the period or periods the stock disposed of was held by the stockholder which disposed of such stock, and such gain shall be included in gross income as a dividend.

(d) **Foreign investment attributable to DISC earnings.**—For the purposes of this part

(1) **In general.**—The amount of foreign investment attributable to producer's loans of a DISC for a taxable year shall be the smallest of

(A) the net increase in foreign assets by members of the controlled group (as defined in section 993(a)(3)) which includes the DISC,

(B) the actual foreign investment by domestic members of such group, or

(C) the amount of outstanding producer's loans by such DISC to members of such controlled group.

(2) **Net increase in foreign assets.**—The term "net increase in foreign assets" of a controlled group means the excess of—

(A) the amount incurred by such group to acquire assets (described in section 1231(b)) located outside the United States over,

(B) the sum of

(i) the depreciation with respect to assets of such group located outside the United States;

(ii) the outstanding amount of stock or debt obligations of such group issued after December 31, 1971, to persons other than the United States persons or any member of such group;

(iii) one-half the earnings and profits of foreign members of such group and foreign branches of domestic members of such group;

(iv) one-half the royalties and fees paid by foreign members of such group to domestic members of such group; and

(v) the uncommitted transitional funds of the group as determined under paragraph (4).

For purposes of this paragraph, assets which are qualified export assets of a DISC (or would be qualified export assets if owned by a DISC) shall not be taken into account. Amounts described in this paragraph (other than in subparagraphs (B)(ii) and (v)) shall be taken into account only to the extent they are attributable to taxable years beginning after December 31, 1971.

(3) **Actual foreign investment.**—The term "actual foreign investment' by domestic members of a controlled group means the sum of—

(A) contributions to capital of foreign members of the group by domestic members of the group after December 31, 1971,

(B) the outstanding amount of stock or debt obligations of foreign members of such group (other than normal trade indebtedness) issued after December 31, 1971, to domestic members of such group,

(C) amounts transferred by domestic members of the group after December 31, 1971, to foreign branches of such members, and

(D) one-half the earnings and profits of foreign members of such group and foreign branches of

domestic members of such group for taxable years beginning after December 31, 1971.

As used in this subsection, the term "domestic member" means a domestic corporation which is a member of a controlled group (as defined in section 993(a)(3)), and the term "foreign member" means a foreign corporation which is a member of such a controlled group.

(4) **Uncommitted transitional funds.**—The uncommitted transitional funds of the group shall be an amount equal to the sum of—

(A) the excess of

(i) the amount of stock or debt obligations of domestic members of such group outstanding on December 31, 1971, and issued on or after January 1, 1968, to persons other than United States persons or any member of such group, but only to the extent the taxpayer establishes that such amount constitutes a long-term borrowing for purposes of the foreign direct investment program, over

(ii) the net amount of actual foreign investment by domestic members of such group during the period that such stock or debt obligations have been outstanding; and

(B) the amount of liquid assets to the extent not included in subparagraph (A) held by foreign members of such group and foreign branches of domestic members of such group on October 31, 1971, in excess of their reasonable working capital needs on such date.

For purposes of this paragraph, the term "liquid assets" means money, bank deposits (not including time deposits), and indebtedness of 2 years or less to maturity on the date of acquisition; and the actual foreign investment shall be determined under paragraph (3) without regard to the

date in subparagraph (A) of such paragraph and without regard to subparagraph (D) of such paragraph.

(5) **Special rule.**—Under regulations prescribed by the Secretary or his delegate the determinations under this subsection shall be made on a cumulative basis with proper adjustments for amounts previously taken into account.

§ 996. ***Rules for Allocation in the Case of Distributions and Losses***

(a) **Rules for actual distributions and certain deemed distributions—**

(1) **In general.**—Any actual distribution (other than a distribution described in paragraph (2) or to which section 995(c) applies) to a shareholder by a DISC (or former DISC) which is made out of earnings and profits shall be treated as made—

(A) first, out of previously taxed income, to the extent thereof,

(B) second, out of accumulated DISC income, to the extent thereof, and

(C) finally, out of other earnings and profits.

(2) **Qualifying distributions.**—Any actual distribution made pursuant to section 992(c) (relating to distributions to meet qualification requirements), and any deemed distribution pursuant to section 995(b)(1)(E) (relating to foreign investment attributable to producer's loans), shall be treated as made

(A) first, out of accumulated DISC income, to the extent thereof,

(B) second, out of the earnings and profits described in paragraph (1)(C), to the extent thereof, and

(C) finally, out of previously taxed income.

(3) **Exclusion from gross income.**—Amounts distributed out of previously taxed income shall be excluded by the distributee from gross income except for gains described in subsection (c)(2), and shall reduce the amount of the previously taxed income.

(b) **Ordering rules for losses.**—If for any taxable year a DISC, or a former DISC, incurs a deficit in earnings and profits, such deficit shall be chargeable—

(1) first, to earnings and profits described in subsection (a)(1)(C), to the extent thereof.

(2) second, to accumulated DISC income, to the extent thereof, and

(3) finally, to previously taxed income, except that a deficit in earnings and profits shall not be applied against accumulated DISC income which has been determined is to be deemed distributed to the shareholders (pursuant to section 995(b)(2)(A)) as a result of a revocation of election or other disqualification.

(c) **Priority of distributions.**—Any actual distribution made during a taxable year shall be treated as being made subsequent to any deemed distribution made during such year. Any actual distribution made pursuant to section 992(c) (relating to distributions to meet qualification requirements) shall be treated as being made before any other actual distributions during the taxable year.

(d) **Subsequent effect of previous disposition of DISC stock—**

(1) **Shareholder previously taxed income adjustment.—If—**

(A) gain with respect to a share of stock of a DISC or former DISC is treated under section 995(c) as a dividend or as gain from the sale or exchange of property which is not a capital asset, and

(B) any person subsequently receives an actual distribution made out of accumulated DISC income, or a deemed distribution made pursuant to section 995(b)(2), with respect to such share,

such person shall treat such distribution in the same manner as a distribution from previously taxed income to the extent that (i) the gain referred to in subparagraph (A), exceeds (ii) any other amounts with respect to such share which were treated under this paragraph as made from previously taxed income. In applying this paragraph with respect to a share of stock in a DISC or former DISC, gain on the acquisition of such share by the DISC or former DISC or gain on a transaction prior to such acquisition shall not be considered gain referred to in subparagraph (A).

(2) **Corporate adjustment upon redemption.**—If section 995(c) applies to a redemption of stock in a DISC or former DISC, the accumulated DISC income shall be reduced by an amount equal to the gain described in section 995(c) with respect to such stock which is (or has been) treated as gain from the sale or exchange of property which is not a capital asset, except to the extent distributions with respect to such stock have been treated under paragraph (1).

(e) **Adjustment to basis.**—

(1) **Additions to basis.**—Amounts representing deemed distributions as provided in section 995(b) shall increase the basis of the stock with respect to which the distribution is made.

(2) **Reductions of basis.**—The portion of an actual distribution made out of previously taxed income shall reduce the basis of the stock with respect to which it is made, and to the extent that it exceeds the adjusted basis of such stock, shall be treated as gain from the sale or exchange of property. In the case of stock includible in the

gross estate of a decedent for which an election is made under section 2032 (relating to alternate valuation), this paragraph shall not apply to any distribution made after the date of the decedant's death and before the alternate valuation date provided by section 2032.

(f) **Definitions of division of earnings and profits.**—For purposes of this part:

(1) **DISC income.**—The earnings and profits derived by a corporation during a taxable year in which such corporation is a DISC, before reduction for any distributions during the year, but reduced by amounts deemed distributed under section 995(b)(1), shall constitute the DISC income for such year. The earnings and profits of a DISC for a taxable year include any amounts includible in such DISC's gross income pursuant to section 951(a) for such year. Accumulated DISC income shall be reduced by deemed distributions under section 995(b)(2).

(2) **Previously taxed income.**—Earnings and profits deemed distributed under section 995(b) for a taxable year shall constitute previously taxed income for such year.

(3) **Other earnings and profits.**—The earnings and profits for a taxable year which are described in neither paragraph (1) nor (2) shall constitute the other earnings and profits for such year.

(g) **Effectively connected income.**—In the case of a shareholder who is a nonresident alien individual or a foreign corporation, trust, or estate, gains referred to in section 995(c) and all distributions out of accumulated DISC income including deemed distributions shall be treated as gains and distributions which are effectively connected with the conduct of a trade or business conducted through a permanent establishment of such shareholder within the United States.

§ 997. ***Special Subchapter C Rules***

For purposes of applying the provisions of subchapter C of Chapter 1, any distribution in property to a corporation by a

DISC or former DISC which is made out of previously taxed income or accumulated DISC income shall—

(1) be treated as a distribution in the same amount as if such distribution of property were made to an individual, and

(2) have a basis, in the hands of the recipient corporation, equal to the amount determined under paragraph (1).

New York Tax Law, Article 9-A
(as in effect in 1972 and 1973)

New York Tax Law § 208. ***Definitions***

As used in this article: l. The term "corporation" includes a joint-stock company or association and any business conducted by a trustee or trustees wherein interest or ownership is evidenced by certificate or other written instrument; a "DISC" and a "former DISC" mean any corporation which meets the requirements of subsection (a) of section nine hundred ninety-two of the internal revenue code of nineteen hundred fifty-four . . . .

New York Tax Law § 208.8-A

8-A. Provided, however, that with respect to a DISC or a former DISC, the following provisions shall apply:

(a) investments in the stocks, bonds or other securities of a DISC or any indebtedness from a DISC shall not be treated as either subsidiary capital or investment capital under subdivisions four or five of this section,

(b) any amounts deemed distributed from a DISC or a former DISC which are taxable as dividends pursuant to subsection (b) of section nine hundred ninety-five of the internal revenue code of nineteen hundred fifty-four shall be treated as business income, except any such amounts from a former DISC attributable to amounts includible in a taxpayer's entire net income for a prior taxable year under subparagraph (B) of paragraph (i) of subdivision nine of this section shall be excluded from entire net income,

(c) any gain recognized for federal income tax purposes on the disposition of stock in a DISC, and any gain recognized on the disposition of stock in a former DISC, includible in gross income as a dividend pursuant to subsection (c) of section nine hundred ninety-five of the

internal revenue code of nineteen hundred fifty-four, shall be treated as business income, and

(d) except as provided in paragraph (i) of subdivision nine of this section, any actual distribution from a DISC or a former DISC shall be treated as business income except an actual distribution which for federal income tax purposes is treated as made out of "other earnings and profits" under section nine hundred ninety-six of the internal revenue code of nineteen hundred fifty-four, in which case such actual distribution shall be treated as either subsidiary income or investment income under this article.

New York Tax Law § 208.9(a)(1)

9. The term "entire net income" means total net income from all sources, which shall be presumably the same as the entire taxable income which the taxpayer is required to report to the United States treasury department, or which the taxpayer would have been required to report, if it had not made an election under subchapter s of chapter one of the internal revenue code, except as hereinafter provided, and subject to any modification required by paragraphs (d) and (e) of subdivision three of section two hundred ten of this article.

(a) Entire net income shall not include:

(1) income, gains and losses from subsidiary capital which do not include the amount of a recovery in respect of any war loss except for such amounts from a former DISC which are treated as business income under subdivision eight-A of this section . . . .

New York Tax Law § 208.9(i)

(i) With respect to a DISC which during any taxable year or reporting year (1) received more than five percent of its gross sales from the sale of inventory or other property which it purchased from its stockholders, (2) received more than five percent of its gross rentals from the rental of property which it purchased or rented from its stockholders or (3) received more

than five percent of its total receipts other than sales and rentals from its stockholders, the following provisions shall apply.

(A) For any taxable year in which subparagraph (B) of this paragraph is in effect and not rendered invalid, a DISC meeting the above test shall be exempt from all taxes imposed by this article.

(B) Supplemental to the provisions of subdivision five of section two hundred eleven of this article, any taxpayer required to compute a tax under this article, which during the taxable year being reported was a stockholder in any DISC meeting the test prescribed in this paragraph, shall for any taxable year ending after December thirty-first, nineteen hundred seventy-one adjust each item of its receipts, expenses, assets and liabilities, as otherwise computed under this article, by adding thereto its attributable share of each such DISC's receipts, expenses, assets and liabilities as reportable by each such DISC to the United States Treasury Department for its annual reporting period ending during the current taxable year of such taxpayer; provided, however, (1) that all transactions between the taxpayer and each such DISC shall be eliminated from the taxpayer's adjusted receipts, expenses, assets and liabilities; (2) that the taxpayer's entire net income as otherwise computed under this section, shall be reduced by subtracting the amount of the deemed distribution of current income, if any, from each such DISC already included in the entire net income of such taxpayer by virtue of having been included in its entire taxable income for that taxable year as reported to the United States Treasury Department; and (3) that in the event this paragraph should be rendered invalid, all DISC's and their stockholders taxable hereunder shall be taxed instead under the remaining portions of this article.

New York Tax Law § 209.6

6. For any taxable year of a DISC, not exempt from tax under paragraph (i) of subdivision nine of section two hundred eight of this article, the taxes imposed by subdivision one of this

section shall be computed only under either clause two or clause four of paragraph (a) of subdivision one of section two hundred ten of this chapter, whichever is greater, and paragraph (b) of such subdivision.

New York Tax Law §§ 210.1-201.3

§ 210. *Computation of Tax*

1. The tax imposed by subdivision one of section two hundred nine of this chapter shall be, in the case of each taxpayer:

(a) a tax (1) computed at the rate of ten per centum on its entire net income, or the portion thereof allocated within the state as hereinafter provided, subject to any modification required by paragraphs (d) and (e) of subdivision three of this section, or (2) computed at one and seventy-eight hundredths mills for each dollar of its total business and investment capital, or the portion thereof allocated within the state as hereinafter provided, except that in the case of a cooperative housing corporation as defined in the internal revenue code, the applicable rate shall be four-tenths of a mill, or (3) computed at the rate of ten per centum on thirty per centum of the taxpayer's entire net income plus salaries and other compensation paid to the taxpayer's elected or appointed officers and to every stockholder owning in excess of five per centum of its issued capital stock minus fifteen thousand dollars (except as hereinafter provided) and any net loss for the reported year, or on the portion of such sum allocated within the state as hereinafter provided for the allocation of entire net income, subject to any modification required by paragraphs (d) and (e) of subdivision three of this section, or (4) two hundred fifty dollars, whichever is greatest, plus

(b) a tax computed at the rate of nine-tenths of a mill for each dollar of the portion of its subsidiary capital allocated within the state as hereinafter provided.

(c) In the case of a taxpayer which is not subject to tax for an entire year the exemption allowed in clause three

of paragraph (a) of this subdivision shall be prorated according to the period such taxpayer was subject to tax.

(d) If the taxable period for which the tax is due is less than an entire year, the minimum tax fixed by clause four of paragraph (a) of this subdivision shall be reduced by twenty-five percentum if the period for which such taxpayer is subject to tax is more than six months but not more than nine months and by fifty percentum if the period for which such taxpayer is subject to tax is not more than six months.

1-a. Notwithstanding any other provision of this chapter, for taxable years beginning before January first, nineteen hundred seventy-eight, an additional tax computed at the rate of five and three-quarters per centum on business income, or the portion thereof allocated within the state as hereinafter provided, is hereby imposed on every corporation subject to the tax imposed by this article which has gross receipts of five hundred thousand dollars or more for the taxable year from transportation, within this state, by omnibuses having a seating capacity of more than seven persons, other than receipts for the operation of school buses which are excluded from entire net income.

1-b. The computation specified in clause three of paragraph (a) of subdivision one shall not apply to a corporation organized under article fifteen of the business corporation law.

2. The amount of subsidiary capital, investment capital and business capital shall each be determined by taking the average fair market value of the gross assets included therein (less, in the case of business capital, average liabilities deductible therefrom which are payable by their terms on demand or within one year from the date incurred, other than loans or advances outstanding for more than a year as of any date during the year covered by the report, and, if the period covered by the report is other than a period of twelve calendar months, by multiplying such value by the number of calendar months or major parts thereof included in such period, and dividing the product thus obtained by twelve.

3. The portion of the entire net income of a taxpayer to be allocated within the state shall be deterined as follows:

(a) multiply its business income by a business allocation percentage to be determined by

(1) ascertaining the percentage which the average value of the taxpayer's real and tang ble personal property within the state during the period covered by its report bears to the average value of all the taxpayer's real and tangible personal property wherever situated during such period;

(2) ascertaining the percentage which the receipts of the taxpayer, computed on the cash or accrual basis according to the method of accounting used in the computation of its entire net income, arising during such period from

(A) sales of its tangible personal property where shipments are made to points within this state,

(B) services performed within the state,

(C) rentals from property situated, and royalties from the use of patents or copyrights, within the state, and receipts from the sales of rights for closed-circuit and cable television transmissions of an event (other than events occurring on a regularly scheduled basis) taking place within the state as a result of the rendition of services by employees of the corporation, as athletes, entertainers or performing artists, but only to the extent that such receipts are attributable to such transmissions received or exhibited within the state and

(D) all other business receipts earned within the state, bear to the total amount of the taxpayer's receipts, similarly computed, arising during such period from all sales of its tangible personal property, services, rentals, royalties, receipts from the sales of rights for closed-circuit and cable television trans-

missions and all other business transactions, whether within or without the state;

(3) ascertaining the percentage of the total wages, salaries and other personal service compensation, similarly computed, during such period of employees within the state, except general executive officers, to the total wages, salaries and other personal service compensation, similarly computed, during such period of all the taxpayer's employees within and without the state, except general executive officers; and

(4) adding together the percentages so determined and dividing the result by the number of percentages; provided, however, for taxable years beginning on or after the first day of January, nineteen hundred seventy-six, the business allocation percentage shall be determined by adding the percentages so determined and an additional percentage equal to the percentage determined under subparagraph two of this paragraph together, and dividing the result by the number of percentages so added together; provided, however, that for taxable years beginning before January first, nineteen hundred seventy-eight, if the taxpayer does not have a regular place of business outside the state other than a statutory office, the business allocation percentage shall be one hundred percent;

Provided, however, that any taxpayer required to adjust its receipts, expenses, assets and liabilities by adding an attributable portion of the receipts, expenses, assets and liabilities of any DISC, as provided by paragraph (i) of subdivision nine of section two hundred eight of this article, shall substitute such adjusted figures in computing the percentages required in subparagraphs one, two and three of this paragraph.

(b) multiplying its investment income by an investment allocation percentage to be determined by

(1) multiplying the amount of its investment capital invested in each stock, bond or other security (other than governmental securities) during the period covered by its

report by the percentage, if any, of the entire capital or the issued capital stock, or the gross direct premiums, or the net income, as the case may be, of the issuer or obligor thereof required to be allocated within the state on the report or reports, if any, required of any such issuer or obligor under this chapter or the insurance law for the preceding year, but without regard to any minimum,

(2) adding together the sums so obtained,

(3) dividing the result so obtained by the total of its investment capital invested during such period in stocks, bonds and other securities (other than obligations of the United States and its instrumentalities and obligations of the state of New York, its political subdivisions and its instrumentalities); provided, however, that in case any investment capital is invested in any stock, bond or other security during only a portion of the period covered by the report, only such portion of such capital shall be taken into account; and provided further, that if a taxpayer's investment allocation percentage is zero, interest received on bank accounts, on obligations of the United States and its instrumentalities and on obligations of the state of New York, its political subdivisions and its instrumentalities shall be multiplied by its business allocation percentage; provided, however, that with respect to corporations organized under article fifteen of the business corporation law, the investment allocation percentage shall be one hundred percent; and

(c) add the products so obtained.

New York Tax Law § 210.13

13. (a) So long as the taxation procedures relating to a DISC provided in subparagraph (B) of paragraph (i) of subdivision nine of section two hundred eight of this article are in effect and not rendered invalid any taxpayer which during the taxable year being reported was a stockholder in any such DISC shall be allowed a DISC export credit, to be computed as hereinafter provided, against the tax imposed by this article

after allowance of any credit permitted under subdivision eleven and subdivision twelve of this section. The amount of the credit shall be computed separately for each such DISC, based upon its operations during its annual reporting period ending during the current taxable year of such stockholder, as follows:

(1) ascertaining the amount, if any, of such taxpayer's attributable share of the total current earnings and profits earned by such DISC for the reporting year which were included in its accumulated DISC income account pursuant to subsection (a) of section nine hundred ninety-six of the internal revenue code of nineteen hundred fifty-four,

(2) ascertaining a percentage by (i) totaling the gross receipts from the sale, lease, rental or other disposition of export property (as defined under subsection (c) of section nine hundred ninety-three of the internal revenue code of nineteen hundred fifty-four) of the taxpayer by or to such DISC, and (ii) totaling such gross receipts from such export property of the taxpayer shipped from a regular place of business of the taxpayer within this state by or to such DISC and then (iii) dividing the total developed in (ii) above by that developed in (i) above (provided, however, for the purposes of this subparagraph, the tax commission may require such gross receipts to be computed on a similar basis for all such export property to properly reflect the percentage of such gross receipts attributable to export property shipped from a regular place of business of the taxpayer within this state),

(3) multiplying the amount ascertained in subparagraph one of this paragraph by the percentage ascertained in subparagraph two of this paragraph,

(4) ascertaining the amount of the taxpayer's taxable income as determined in subparagraphs one, two and three of this paragraph that is eligible for credit by multiplying the product ascertained in the preceding subparagraph by

the taxpayer's business allocation percentage determined as provided in paragraph (a) of subdivision three of this section,

(5) the amount of DISC export credit attributable to the operations of each such DISC is then found by multiplying seventy percent of the taxpayer's taxable income that is eligible for credit, as computed in the preceding subparagraph, by the rate of tax applying to the taxpayer, as provided in subdivision one of this section,

(6) the taxpayer's total DISC export credit is the sum of the DISC export credits attributable to each DISC that qualifies for tax exemption under paragraph (i) of subdivision nine of section two hundred eight of this article, in which it was a stockholder during the taxable year being reported.

(b) The credit allowed under this subdivision for any taxable year shall not reduce the tax due for such year to less than the minimum fixed by clause four of paragraph (a) of subdivision one of this section; nor may any unused credit be carried over to any following year.

New York Tax Law § 211. ***Reports***

1. Every taxpayer, as well as every foreign corporation having an employee, including any officer, within the state, shall annually on or before March fifteenth transmit to the tax commission a report in a form prescribed by it (except that a corporation which reports on the basis of a fiscal year shall transmit its report within two and one-half months after the close of its fiscal year and except, also, that a corporation which is a DISC shall transmit its report on or before the fifteenth day of the ninth month following the close of its calendar or fiscal year), setting forth such information as the tax commission may prescribe and every taxpayer which ceases to exercise its franchise or to be subject to the tax imposed by this article shall transmit to the tax commission a report on the date of such cessation or at such other time as the tax commission may

require covering each year or period for which no report was theretofore filed. Every taxpayer shall also transmit such other reports and such facts and information as the tax commission may require in the administration of this article. The tax commission may grant a reasonable extension of time for filing reports whenever good cause exists.

An automatic extension of three months for the filing of its annual report shall be allowed any taxpayer if, within the time prescribed by the preceding paragraph, such taxpayer files with the tax commission an application for extension in such form as said commission may prescribe by regulation and pays on or before the date of such filing the amount properly estimated as its tax.

New York Tax Law § 211.4

4. In the discretion of the tax commission, any taxpayer, which owns or controls either directly or indirectly substantially all the capital stock of one or more corporations, or substanially all the capital stock of which is owned or controlled either directly or indirectly by one or more other corporations or by interests which own or control either directly or indirectly substantially all the capital stock of one or more other corporations, may be required or permitted to make a report on a combined basis covering any such other corporations and setting forth such information as the tax commission may require; provided, however, that any corporation which owns or controls either directly or indirectly substantially all the capital stock of a DISC not exempt from tax under paragraph (i) of subdivision nine of section two hundred eight of this article shall be allowed, at the election of such corporation, to make a report on a combined basis covering such DISC, but the failure of such corporation to make such election shall not prohibit the tax commission from requiring a combined report covering such corporation and such DISC; provided, further, that no combined report covering any corporation not a taxpayer shall be required unless the tax commission deems such a report necessary, becaue of intercompany transactions or some agreement,

understanding, arrangement or transaction referred to in subdivision five of this section, in order properly to reflect the tax liability under this article. In the case of a combined report the tax shall be measured by the combined entire net income or combined capital, of all the cororations included in the report. In computing combined entire net income intercorporate dividends shall be eliminated, in computing combined business and investment capital intercorporate stockholdings and intercorporate bills, notes and accounts receivable and payable and other intercorporate indebtedness shall be eliminated and in computing combined subsidiary capital intercorporate stockholdings shall be eliminated, provided, however, that intercorporate dividends from a DISC or a former DISC not exempt from tax under paragraph (i) of subdivision nine of section two hundred eight of this article which are taxable as business income under this article shall not be eliminated.

Office - Supreme Court,
FILED
JUL 19 1982
ALEXANDER L. STE
CLERK

No. 81-2394

IN THE

Supreme Court of the United States

OCTOBER TERM, 1981

WESTINGHOUSE ELECTRIC CORPORATION,
Appellant,

-against-

JAMES H. TULLY, JR., *et al.*,
AS THE TAX COMMISSION OF THE STATE OF NEW YORK,
Appellees.

APPEAL FROM THE COURT OF APPEALS OF THE STATE OF NEW YORK

SUPPLEMENTAL APPENDIX TO JURISDICTIONAL STATEMENT

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Of Counsel

No. 81-2394

In The

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October Term, 1981

Westinghouse Electric Corporation,
Appellant,

-against-

James H. Tully, Jr., *et al.*,
As The Tax Commission of The State of New York,
Appellees.

APPEAL FROM THE COURT OF APPEALS OF THE STATE OF NEW YORK

SUPPLEMENTAL APPENDIX TO JURISDICTIONAL STATEMENT

In compliance with Rule 28.1 of the Rules of the Supreme Court, the following list names all affiliates and subsidiaries (except wholly owned subsidiaries) of appellant Westinghouse Electric Corporation.

Domestic subsidiaries and affiliates:

Bayou Cablevision, Inc.
Bridgeport Community Antenna Television Company
Cable TV General, Inc.
CATV Enterprises, Inc.
Community Cablevision (Pennsylvania) (a partnership)
El Paso Cablevision, Inc.
Focus Cable of Oakland, Inc.
Grosse Point Cable, Inc.
Home Theater Network, Inc.
Kaiser-Teleprompter of Hawaii, Inc.
Offshore Power Systems (a partnership)
Piedmont Cablevision, Inc.
Saw Mill River Cablevision, Inc.
Showtime Entertainment (a partnership)
Southwest Video Corporation
Telcom Cablevision, Inc.
Teleprompter of Avon Lake, Inc.
Teleprompter of Columbia Heights/Hilltop, Inc.
Teleprompter Community Cablevision (Texas)
(a partnership)
Teleprompter of Denver, Inc.
Teleprompter of Erie, Inc.
Teleprompter of Kentucky, Inc.
Teleprompter of Lorain County, Inc.
Teleprompter of Milwaukee, Inc.
Teleprompter of St. Bernard, Inc.
Teleprompter of St. Paul, Inc.
Teleprompter of Sacramento, Inc.
Teleprompter of Sheffield Lake, Inc.
Teleprompter of Worcester, Inc.

Foreign subsidiaries and affiliates:

Ateliers de Constructions Electriques de Charleroi, S.A.
CDSW Ireland Limited
China Industry Services Co., Ltd.
CMW Equipamentos, Ltda.

CMW Sistemas, Ltda.
Compagnie des Dispositifs Semiconducteurs Westinghouse
Eletromar Industria Eletrica Brazileira, S.A.
Eletromar Nordeste, S.A.
Eletroncontroles Villares, Ltda.
Ercole Marelli & Company, S.p.A.
Etic B.V.
Funktionelle Musik GMBH
Galileo Argentina C.I.S.A.
Galileo Uruguaya, S.A.
IEM S.A.
Industrias Electronicas, S.A.
Industry Services Company of Saudi Arabia, Ltd.
Living & Learning (Cambridge), Ltd.
Mecanica Pesada, S.A.
Mitsubishi Nuclear Fuel Co., Ltd.
Motores Electricos de Juarez S.A. de C.V.
Ottermill Products Limited
Schneider S.A.
Societa Progettiazione Reattori Nucleari, S.p.A.
T.P.I. S.A. de C.V.
Transformadores de Distribucion Trade, S.A.
Transformadores TPL S.A.
Tyree Industries Limited
Tyree-Power Construction Limited
Westinghouse Canada Inc.
Westinghouse Asia Controls Corp.
Westinghouse Electric Supply Company of Saudi Arabia
Westinghouse Electro Metalurgicas C.A.
Westinghouse Electric-MK Limited
Westinghouse (Jamaica) Ltd.
Westinghouse Proyectos Electricos, S.A.
Westinghouse, S.A.
Wexico Systems and Services, Ltd.

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Office-Supreme Court, U.S.
FILED
MAY 4 1983
ALEXANDER L. STEVAS,
CLERK

No. 81-2394

IN THE

Supreme Court of the United States

OCTOBER TERM, 1982

WESTINGHOUSE ELECTRIC CORPORATION,
Appellant,

-against-

JAMES H. TULLY, JR., *et al.*,
AS THE TAX COMMISSION OF THE STATE OF NEW YORK,
Appellees.

ON APPEAL FROM THE COURT OF APPEALS OF THE STATE OF NEW YORK

JOINT APPENDIX

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JURISDICTIONAL STATEMENT FILED JUNE 30, 1982
PROBABLE JURISDICTION NOTED JANUARY 17, 1983

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Decision of the Tax Commission of the State of New York	August 31, 1979
Notice of Petition and Verified Petition filed by Westinghouse in Supreme Court of the State of New York, Albany County	December 21, 1979
Verified Answer and Return filed by Tax Commission	January 10, 1980
Order of Supreme Court, Albany County, transferring proceedings to Appellate Division of the Supreme Court, Third Judicial Department	January 25, 1980
Oral argument in Appellate Division	April 29, 1981
Decision of Appellate Division annulling Tax Commission determination	June 18, 1981
Order of Appellate Division	June 29, 1981
Notice of Appeal to Court of Appeals of the State of New York filed by Tax Commission	July 20, 1981
Notice of Cross-Appeal to Court of Appeals filed by Westinghouse	August 3, 1981
Oral Argument in Court of Appeals	February 9, 1982
Decision of Court of Appeals reinstating decision of Tax Commission	April 1, 1982
Order of Court of Appeals remitting case to Supreme Court, Albany County	April 1, 1982
Judgment entered in Supreme Court, Albany County	April 16, 1982
Notice of Appeal to Supreme Court of the United States filed	June 28, 1982

FIELD AUDIT REPORT - CORPORATION TAX

BUFFALO DISTRICT OFFICE

CORPORATION NAME AND ADDRESS WESTINGHOUSE ELECTRIC CORPORATION WESTINGHOUSE BUILDING, GATEWAY CENTER PITTSBURGH, PENNSYLVANIA 15222	EIN 25-0677540 FILE # 321 787.00 DATE RECEIVED 1/24/74
STATE & DATE OF INCORPORATION: PA 4/9/1872 | DATE BEGAN BUSINESS IN N.Y.: 2/26/43 | BUSINESS GROUP CODE #: 3611-3698 | TAXABLE UNDER ARTICLES: 9A	DATE ASSIGNED 7/12/74
BUSINESS ACTIVITY MFG., SALE & INSTALLATION OF ELECTRICAL & STEAM APPARATUS	DATE RETURNED MAY 7, 1976
REPRESENTATIVE'S NAME AND ADDRESS MR. RALPH J. WEILAND—TAX DEPARTMENT WESTINGHOUSE BUILDING, GATEWAY CENTER PITTSBURGH, PENNSYLVANIA 15222 TELEPHONE # 412 255-3382	TOTAL AUDIT MAN-DAYS 44½ ADDITIONAL TAX $225,406.99 INTEREST $ 42,176.40 TOTAL $267,583.39
CONSENT SIGNED? ☐ YES ☒ NO | CORP. AGREES? ☐ YES ☒ NO	REFUND REQUESTED $
FORWARDED MATERIAL RETURNED: NYS Franchise Tax Reports for CY 1968, and CY's 1961-1973 CT-8 based on CY 1967, CT-3360 reports for CY's 1968-1970 Prior field audit report covering CY's 1965-1968 License Fee Data Correspondence	AUDITED REFUND $ REDUCED REFUND $
NEW MATERIAL OBTAINED: CT-318 extending the CY 1970 to 11/15/75 CT-318 extending the CY's 1970 & 1971 to 11/15/76 Copies of taxpayer's letters dated 4/26/76 & 9/3/75	AMOUNT COLLECTED $ -0- FUTURE POSSIBLE TAX EFFECT $

SUMMARY OF YEARS AUDITED AS REPORTED:

YEAR	ENTIRE NET INCOME	BUS. ALLOC.	TAX BASIS	TAX AMOUNT
CY 1973	43,715,850	6.239516%	INC	205,848
1972	136,516,711	6.387743%	INC	749,384
1971	86,344,898	7.089093%	INC	808,413
1970	60,735,141	8.064358%	INC	139,923

SUBMITTED:

/s/ R.L. Gritzke
R. L. GRITZKE

/s/ R.H. Stein
R. H. STEIN

ANALYSIS OF AUDIT ADJUSTMENTS

ADJUSTMENT AREA	TAX EFFECT
1. FEDERAL CHANGES	$
2. INTEREST TO STOCKHOLDERS	
3. DEDUCTIONS ATTR. TO SUB. CAP./INCOME	
4. NET OPER. LOSS DEDUCT.	
5. OTHER E.N.I. ADJUSTMENTS	224,073
6. OPTIONAL DEPRECIATION	
7. BUSINESS ALLOCATION FACTORS	(808)
8. INVESTMENT INCOME, CAPITAL AND ALLOCATION	
9. SUBSIDIARY CAPITAL AND ALLOCATION	
10. TAX CREDITS CHANGES—DISC EXPORT CR.	(6,859)
11. BALANCE OF AUDIT ADJUSTMENTS	

REVIEWED

/s/ R.H. Stein
R. H. STEIN

APPROVED

Anthony J. Palmer
DISTRICT TAX SUPERVISOR

BY:
/s/ S.B. Friedson
CHIEF CORPORATION SECT.

S. B. Friedson

CENTRAL OFFICE USE

Related Cases:

AMERICAR, INC.	E.I.N. 59-1050690 FILE NO. 014 169.50
CREDIT SERVICES, INC.	E.I.N. 13-2501295 FILE NO. 071 799.75
GROUP W PRODUCTIONS (Previously returned to Albany on 10/28/75)	E.I.N. 13-1929317 FILE NO. 127 567.55
K. W. BATTERY COMPANY	E.I.N. 25-1191356 FILE NO. 159 697.10
LONGINES-WITTNAUER, INC.	E.I.N. 13-0983160 FILE NO. 182 030.00
LONGINES-WITTNAUER WATCH CO.	E.I.N. 13-0983160 FILE NO. 182 027.00
RADIO ADVERTISING REPRES. INC.	E.I.N. 13-1886810 FILE NO. 246 382.25
TELEVISION ADVERTISING REPRES. INC.	E.I.N. 13-1887580 FILE NO. 297 376.00
WESTINGHOUSE BROADCASTING CO. INC. (DEL.)	E.I.N. 13-1969056 FILE NO. 321 785.50
WESTINGHOUSE BROADCASTING CO. INC. (IND.) (Previously returned to Albany on 10/28/75)	E.I.N. 13-1805539 FILE NO. 321 788.00
WESTINGHOUSE CREDIT CORPORATION	E.I.N. 25-1007352 FILE NO. 321 786.00
WESTINGHOUSE LEASING CORPORATION	E.I.N. 25-1193025 FILE NO. 321 788.10

EXPLANATION

The files of Westinghouse Electric Corporation and other affiliated companies were forwarded to the Buffalo District Office for general verification purposes.

The examination of Westinghouse Electric Corporation covered the CY's 1970 through 1973.

FINDINGS

General

Westinghouse Electric Corporation was incorporated in Pennsylvania on April 9, 1872 and began business in New York State on February 26, 1943. This company files on a Federal Consolidated Return with numerous affiliated companies.

The taxpayer manufactures and sells thousands of highly diversified basic products, ranging from home appliances to commercial nuclear power plants and from integrated circuits to water desalting plants. Included among its products are steam and gas turbines; mechanical equipment required by power companies, railroads and industry; propulsion and electronic equipment for the Navy and Marine industry and other equipment for the aerospace industry.

Household appliances and related products are distributed by independent distributors and dealers and through two sales divisions. The other products manufactured are, in general, sold to customers through other sales organizations of the company which have main and branch offices throughout the United States, and in certain cases through independent distributors and dealers. In December of 1974, Westinghouse Electric Corporation agreed to sell its major appliance business to White Consolidated Industries.

The company maintains plants and other facilities throughout the country for the maintenance and repair of equipment and appliances of its own manufacture and some equipment manufactured by others.

All shipments of its own products originate either from its own plants or company operated warehouses. In some cases, items are manufactured or processed by independent contractors and shipped to customers from these points.

In addition, to its own research and development activities, carried on at Pittsburgh, Pennsylvania, the taxpayer operates two additional facilities for the United States Navy, identified as the Bettis installation and P.A.D.

In the case of Bettis, an atomic power research unit, the taxpayer operates a government-owned facility, with some funds advanced by the government for materials and inventory. Research is carried on by Westinghouse employees who are paid by the taxpayer, although the funds are indirectly advanced by the Federal Government. Approximately 50% of the work is let out to subcontractors.

In the case of P.A.D., a rented facility, the taxpayer acts as a procurement agent for the government in the implementation of certain Navy projects. The government is billed for certain material and wages involved and the taxpayer is subsequently reimbursed for any expenditures.

The company's general offices are located in Pittsburgh, Pennsylvania. New York plants are located at Buffalo, Bath and Klaira, with storage and repair facilities located at strategic areas of the state. The New York main sales office, located at the Pan Am Building in New York City, covers all of New York State and parts of Connecticut and New Jersey. Smaller branch offices are located throughout the state.

A prior field audit was conducted on this company by the Buffalo District Office which covered the C. Y.'s 1965 through 1968.

Federal Changes

The results of changes in Federal Taxable Income have been reported through CY 1970. Federal changes for years subsequent to 1970 have not been finalized, and it is recom-

mended that returns for these years be retained until Federal changes are reported.

This company's CT-3360's Report of Change in Taxable Income by U. S. Treasury Department, were examined and found to be in order for the CY's 1969 and 1970. These were the only two years open under the Statute of Limitations.

No adjustments are recommended in this area.

Entire Net Income

The tax base for the entire audit period was allocated net income.

Federal Taxable Income, as reported for franchise tax purposes, was verified to line 28 of the taxpayer's Federal 1120 report for all years under audit.

Federal non-taxable interest income and the taxpayer's New York State Franchise Tax deduction on its federal return were correctly added back and no interest was paid to stockholders.

The deductions claimed for interest, dividends, and capital gains from subsidiary capital, and 50% of dividends from non-subsidiary companies were found to be correct for all years under audit.

Federal depreciation on qualified property was correctly added back and the taxpayer made a proper deduction for foreign taxes on which it claimed a credit on its Federal Return. The foreign tax deduction was composed of all foreign taxes paid on royalities, interest and sales; and 50% of foreign taxes on non-subsidiary dividends.

The taxpayer has been reporting an add back for interest expense attributable to subsidiary capital on the basis of a formula prescribed in a prior field audit report. According to this formula, the taxpayer was to specifically set out increases in notes receivable from Westinghouse Credit Corporation as being related to long-term borrowings. The taxpayer's effective rate of interest on long-term borrowings for the year of the

borrowing was to be applied against this balance to arrive at interest expense attributable to subsidiary capital.

In addition to this add back shown on its CT-3, the taxpayer has been making an add back for interest expense attributable to subsidiary capital (other than Westinghouse Credit Corporation) on its Federal 1120 via a contra account to other deductions.

This add back was based on the taxpayer's investment in these subsidiaries and loans and advances to these companies.

Test computations indicated that an indirect attribution on a formula basis applying the ratio of subsidiary assets over total assets to interest expense would not yield an add back greater than that made by the taxpayer.

Consequently, it is recommended that the taxpayer's treatment of interest expense attributable to subsidiary capital be accepted.

The taxpayer's treatment of Optional Depreciation and the taxpayer's Domestic International Sales Corporation are covered in subsequent sections of this report.

Optional Depreciation

This company has been claiming optional depreciation on qualified property acquired between 1964 and 1967, which had a New York situs. The taxpayer has properly accounted for depreciation taken on these assets over the years for both Federal and State purposes.

When a disposition is made by retirement or sale, the taxpayer does not recognize a capital gain or loss for Federal purposes but instead elects to use the accounting treatment provided for in IRC Reg. 1.167 (a)7(b) for multiple asset or group accounting.

Under this method, there is a credit to assets for the full cost of the item and to accumulated depreciation for any proceeds received with corresponding debits to accumulated depreciation and cash respectively. Where there are no pro-

ceeds on disposal accumulated depreciation is debited for the full cost of the asset.

For disposals of qualified New York State property, the taxpayer credits assets and debits accumulated Federal and New York State Optional Depreciation for the full cost of the item. Any proceeds received are added directly to allocated income.

Under this method, the taxpayer will be accounting for the difference between the New York and Federal basis by future add backs of Federal depreciation to entire net income.

It should be noted that the taxpayer transferred some machinery and equipment on which it has been claiming optional depreciation from Buffalo, New York to a plant located in Virginia in CY 1972 which had a cost of $4,806,705. This was handled in the same manner as a disposal of qualified New York property. The difference between the New York and Federal basis will be accounted for as in the case of disposals by future add backs of federal depreciation to entire net income.

The taxpayer's control of qualified property and its method of accounting for federal and state depreciation and gains on qualified property were found to be acceptable. No adjustments are recommended in this area.

DISC

Westinghouse Electric Export Corporation, a wholly owned subsidiary of Westinghouse Electric Corporation, was incorporated on December 22, 1971, and filed its election to be treated as a DISC on February 21, 1972. The corporation has filed Federal 1120 DISC returns for the CY's 1972 and 1973.

This DISC's total income consisting primarily of commission income was $25,987,000 and $57,948,738 for the CY's 1972 and 1973, respectively. Westingthouse Electric Corporation has reported its deemed dividend from this DISC of $12,596,500 and $29,838,006 for the CY's 1972 and 1973, respectively, as business income on its CT-3 reports.

Westinghouse Electric Export Corporation acts as a commission agent in the export sale of electrical and steam apparatus products which are manufactured by Westinghouse Electric Corporation and several other affiliated companies. Commission income received from the sale of Westinghouse Electric Corporation's products represents over 80% of this company's income. The other 20% is from affiliates who are not New York taxpayers. This DISC has no employees of its own and it does not own any real or personal tangible property, or pay any real estate rentals.

Since Westinghouse Electric Export Corporation meets the more than 5% test, with its stockholders, it is a tax exempt DISC and Westinghouse Electric Corporation is required by law to file form CT-3C, New York State Consolidated Franchise Tax Report. Since the taxpayer has not filed a consolidated report for 1972 and 1973, we have reflected the tax on a consolidated basis for these years in Schedule "B".

The computation of additional income which consists of the DISC's total income, less the "deemed dividend" reported as business income by Westinghouse Electric Corporation, is detailed in Schedule "B". The denominator of the receipts factor has also been increased as detailed in Schedule "D", to reflect total commission income as business income of the DISC less commission received from Westinghouse Electric Corporation which would be an elimination on the consolidated report. In addition, the allowable DISC export credit has been computed in Schedule "D". Approximately 5% of the stockholders' total export shipments are made from regular places of business in New York State.

The taxpayer has been advised to file forms CT-3C, the Consolidated Franchise Tax Report, and CT-3B, the Information Report for tax exempt DISC's for subsequent tax periods.

The corporation has protested the taxation of the deferred income of the DISC which is covered under the "Taxpayer Protest" section of this report.

BUSINESS ALLOCATION

Property Factor

The taxpayer correctly reported the AFMV of real and tangible personal property owned based on an annual average of net book values.

This company properly excluded personal property rentals and included the current years amortization of leasehold improvements in its computation of the capitalized value of real estate rented for all years under audit.

No adustments are recommended.

Receipts Factor

Sales of tangible personal property were correctly reported on a destination basis for all years under audit. The taxpayer correctly included Turn Key billings (derived from nuclear power plants built for utilities) and receipts from Bettis and P.A.D. (described in the general section of this report) at net rather than gross, as recommended by the Bureau after the last field audit conducted on this company. These receipts have been decreasing and no longer have a material effect.

Rentals of property and royalties were also examined and found to be correctly allocated.

No adjustments to the receipts factor would be required for Westinghouse Electric Corporation on an individual basis, but as discussed earlier in the DISC section of this report, the denominator of the Receipts Factor is being adjusted to reflect the business receipts of the DISC as detailed in Schedule "C".

Payroll Factor

Gross payroll was correctly reflected in both the numerator and denominator of the payroll factor. The taxpayer properly excluded general executive officers, and correctly included other officers whose responsibilities and authority are limited by territory.

No adjustments are recommended in this area.

Total Capital

In no year under audit was the tax base allocated capital.

This corporation computed the AFMV of Total Capital using total assets, per its balance sheet, averaged on an annual basis plus the excess of the AFMV of subsidiary capital (Schedule "C" CT-3) over the valuation of subsidiary assets reflected in its balance sheet, less current liabilities.

Current liabilities were examined and although there is a possibility that some adjustments could be made in this area, such adjustments would not have the affect of producing a tax based on allocated capital, larger than that based on allocated income.

No adjustments are recommended in this area.

Subsidiary Capital & Allocation

The taxpayer computed the AFMV of subsidiary capital using either the individual subsidiary's total capital or equity plus loans and advances averaged on an annual basis. It should be noted that in most cases, total capital was approximately equal to equity plus loans and advances. Some negative AFMV's were used but these are minor when compared to the total. No meaningful distortion resulted from this treatment by the taxpayer and any adjustments in this area would not have a significant tax effect.

As described earlier in this report, the taxpayer accounted for the difference in basis between its balance sheet valuation of cost and that used in its computation of the AFMV of subsidiary capital.

Examination of the subsidiary allocation percentages used by the taxpayer revealed that stock allocation percentages were used in most instances. On occasion, a business allocation percentage was used instead, but over all, no significant tax effect would result from adjustments in this area.

No adjustments are recommended.

Investment Capital, Allocation and Income

The AFMV of Investment Capital was generally valued at cost, per the taxpayer's balance sheet, averaged on an annual basis. Besides investments in non-subsidiary companies, the taxpayer included obligations of the United States and its instrumentalities; New York, its political subdivisions and instrumentalities and cash.

The issuers' allocation percentages employed by the taxpayer were examined and found to be substantially correct.

The taxpayer's treatment of investment capital and its allocation to New York appears to adequately reflect an understated AFMV. No adjustments are recommended.

Investment Income, as reported, consisted of 50% of dividends from non-subsidiary companies, less the foreign taxes applicable to this dividend income, plus interest income from state and municipal obligations and non-subsidiary companies.

This company did not include gains and losses on the sale of securities held for investment in investment income during the audit period. Since these gains and losses tended to offset each other, no adjustments are recommended to investment income.

Intercompany Transactions, Arrangements & Combined Reports

The taxpayer's subsidiaries are, in general, autonomous in nature with employees of their own and independent places of business. Merchandise transactions are consummated at the equivalent of "arms length" and the taxpayer is reimbursed by its subsidiaries for services rendered in their behalf. No distortion to the New York Tax base from transactions between the parent company and other affiliated companies is evident and the financial status of each company can be independently determined.

Particular attention was given to Westinghouse Credit Corporation and Westinghouse Leasing Corporation. West-

inghouse Credit Corporation is a wholly owned subsidiary of Westinghouse Electric Corporation and is engaged in the financing of equipment and other products in the industrial, commercial and consumer fields. Approximately 98% of the financing provided is for non-Westinghouse products and this company has its own offices and employees.

Westinghouse Leasing Corporation is a wholly owned subsidiary of Westinghouse Credit Corporation. This company owns equipment and leases it to others. It receives all of its financing from Westinghouse Credit Corporation and approximately 50% of its equipment is purchased from Westinghouse Electric Corporation. This company has no employees of its own and relies upon Westinghouse Credit Corporation's employees to handle all of its business operations.

The taxpayer inquired into the possibility of placing these two New York taxpayers, Westinghouse Credit Corporation and Westinghouse Leasing Corporation, on a combined reporting basis. The taxpayer was advised that permission for a combined report would not be granted on a retroactive basis. It was noted that a combined report for these two New York taxpayers would not produce a tax greater than that already paid on an individual basis. It is doubtful that the taxpayer will request permission to include these two companies on a combined report for subsequent periods.

A combined report for Westinghouse Electric Corporation, together with these two companies, would produce a tax greater than that paid on an individual basis but the facts outlined above do not warrant this combination. Consequently, combined reports are not recommended at this time.

Investment Tax Credit

The taxpayer claimed an investment tax credit for each year under audit.

Our examination revealed that the property on which the investment tax credit was claimed is used principally in the manufacturing process, has a situs in New York State, and is otherwise qualified for this credit.

The taxpayer properly computed a recapture of excess credit taken in prior years on property that was disposed of or ceased to be in qualified use prior to the end of its useful life.

No adjustments are recommended in this area.

License Fee

The taxpayer accumulated license fee payments through 1957 totaled $28,528.43. The license fee was examined for the years under audit and no additional amount is due.

Taxpayer Protest

The Corporation has disagreed with our audit adjustment requiring it to file on a consolidated basis with its tax exempt DISC. The objection is based solely on constitutional grounds, as stated in their letter of 9/3/75 which is enclosed. The taxpayer feels our law is "unconstitutional" and has indicated a willingness to take this issue to court. A conference was held at the Buffalo District Office on 12/22/75 and all other audit issues were resolved.

RECOMMENDATION

Based on our audit findings, it is recommended that a Notice of Deficiency be issued in the amount of $267,583.39 as detailed in Schedule "A". The corporation will petition for redetermination of deficiency after formal billing.

ATTACHED SCHEDULES

A. Summary of Additional Tax Due

B. Computation of Additional Tax Due—Per Audit

C. Computation of the Business Allocation Percentage

D. Computation of the DISC Export Credit

WESTINGHOUSE ELECTRIC CORPORATION

Summary of Additional Tax Due

Schedule "A"

CY	Additional Tax Due—Per Audit (Schedule "B")	Interest to May 15, 1976		Total
1973	$151,436.76	$24,608.47	16.25%	$176,045.23
1972	73,970.23	17,567.93	23.75%	91,538.16
1971	—	—		—
1970	—	—		—
Totals	$225,406.99	$42,176.40		$267,583.39

WESTINGHOUSE ELECTRIC CORPORATION

Computation of Additional Tax Due—Per Audit

Schedule "B"

	CY 1973		CY 1972	
Entire Net Income—as reported (inclusive of adjustments for changes in Federal Taxable Income reported on CT-3360, CY 1970)		$43,715,850		$136,516,711
Total DISC Income—per Federal 1120 DISC Report	$57,948,738		$25,987,000	
Less: "Deemed Dividend" already reflected in Entire Net Income	27,838,006		12,596,500	
Adjustment to include DISC Income on a Consolidated Basis		28,110,732		13,390,500
Entire Net Income—per audit		71,826,582		149,907,211
Investment Income—as reported	396,586	396,586	579,278	579,278
Business Income—per audit		71,429,996		149,327,933
Business Allocation Percentage—per audit, from Schedule "C"		6.234494%		6.394454%
Allocated Business Income—per audit		4,453,291		9,533,773
Investment Allocation Percentage—as reported	.001373%		.000856%	
Allocated Investment Income		5		5
Total Allocated Income—per audit		4,453,304		9,533,778
N. Y. Gain or (Loss) on Qualified Property—as reported		21,602		5,555
Optional Depreciation on Qualified N. Y. Property—as reported		(156,584)		(172,733)
Taxable Net Income—per audit		4,318,322		9,366,600
Tax on Taxable Net Income @ 9% for the CYs 71-73, 7% for CY 1970	388,648.98		842,994.00	
Tax on Allocated Subsidiary Capital—as reported	28,182.00		24,584.00	
Investment Tax Credit—as reported	(53,748.00)		(41,654.00)	
DISC Export Credit—from Schedule "D"	(6,098.22)		(2,569.77)	
Tax—per audit		356,784.76		823,354.23
Tax—as reported		205,548.00		749,384.00
Additional Tax Due—per audit, to Schedule "A"		$151,436.76		$ 73,970.23

WESTINGHOUSE ELECTRIC CORPORATION

Computation of the Business Allocation Percentage

Schedule "C"

	CY 1973		CY 1972	
	New York	Everywhere	New York	Everywhere
Property Factor:				
Percentage in N. Y.—as reported	5.636229%		5.873047%	
Receipts Factor:				
Total Receipts—as reported	228,761,326	4,038,022,730	218,139,529	3,668,854,313
Adjustments to include DISC Receipts on a Consolidated basis:				
Add: Total DISC Commission Income	—	55,265,711	—	25,987,000
Deduct: DISC Commission Income received from Westinghouse Electric Corporation	—	44,497,105	—	19,888,000
Total Receipts—per audit	228,761,326	4,048,791,336	218,139,529	3,674,953,313
Percentage in N. Y.—per audit	5.650114%		5.935845%	
Payroll Factor:				
Percentage in N. Y.—as reported	7.417141%		7.344470%	
Total New York State Percentages	18.703483%		19.153362%	
Business Allocation Percentage—per audit, to Schedule "B"	6.234494%		6.384454%	

WESTINGHOUSE ELECTRIC CORPORATION

Computation of the DISC Export Credit

Schedule "D"

	CY 1973		CY 1972	
Entire Net Income of DISC	57,948,738		25,987,000	
Less: Deemed Dividend Distribution	29,838,006		12,596,500	
Attributable Base (100% owned DISC)		28,110,732		13,390,500
N.Y. Receipts (stockholder's export property receipts from DISC where shipments were made from stockholder's regular place of business in New York)	22,539,000		10,668,000	
Total Receipts (stockholder's total export property receipts from its DISC)	408,080,000		223,587,000	
Percentage of Shipments from New York		5.523182%		4.771297%
Eligible Base		1,552,607		638,901
Business Allocation Percentage, from Schedule "C"		6.234494%		6.384454%
Allocated Eligible Base		96,797		40,790
70% of Allocated Eligible Base	67,758		28,553	
Tax Rate	.09		.09	
DISC Export Credit—per audit, to Schedule "B"		609,822		256,977

T.A. 16 (1/77)

STATE OF NEW YORK

STATE TAX COMMISSION

IN THE MATTER OF THE PETITION

OF

(1) Westinghouse Electric Corporation

for (2) Redetermination of Deficiencies in the Franchise Tax on Business Corporations under Article 9-A of the Tax Law for the years 1972 and 1973

PERFECTED PETITION

IDENTIFYING NO. (3) 25-0677540
for tax administration purposes only

Petitioner Westinghouse Electric Corporation, Attn: Tax Department Telephone No. (412) 255-3800

Address (4) Westinghouse Building, Gateway Center, Pittsburgh, Pennsylvania 15222

Petitioner's representative, if any Henry W. de Koenigsberg Telephone No. (212) 422-3000

Address Cravath, Swaine & Moore, One Chase Manhattan Plaza, New York, N.Y. 10005

The petitioner hereby petitions for (5) a redetermination of deficiencies in the franchise tax on business corporations under Article 9-A of the Tax Law for pursuant to the New York State Tax Law, and in support of such petition the years 1972 and 1973 and claims a refund for taxes paid for such years alleges the following:

The petitioner received (6) notices of deficiencies

pursuant to (7) Article 9-A, Franchise Tax on Business Corporations Dated (8) 6/15/76

from (9) the corporation tax bureau

The notice provided that the tax or taxes determined were for the years or periods in the amounts of: (10)

(A) YEAR OR PERIOD	(B) TAX ARTICLE	(C) AMOUNT OF TAX DETERMINED	(A) YEAR OR PERIOD	(B) TAX ARTICLE	(C) AMOUNT OF TAX DETERMINED
1972	9-A	$ 73,970.23 plus interest			$
1973	9-A	$151,436.76 plus interest			
			TOTALS		$225,406.99 plus interest

The petitioner alleges that the (11) corporation tax bureau made the following errors: (12)

(1) The bureau calculated deficiencies of $73,970.23 for 1972 and $181,436.76 for 1973, plus interest, by erroneously including in the petitioner's entire net income certain income of Westinghouse Electric Export Corporation ("DISC").

(2) Even if the bureau is correct in increasing the petitioner's entire net income, the bureau has erred in calculating the adjustment for 1972 as follows: The DISC's taxable income for 1972 was $25,987,000, from which the bureau subtracted $12,596,500 as the deemed dividend already included in the petitioner's entire net income for 1972, to arrive at an adjustment of $13,390,500. In fact, DISC's deemed distributions included in the petitioner's entire net income for such year totalled $12,956,500. Therefore, under the bureau's theory the petitioner's entire net income should only have been increased by $13,030,500 for 1972.

(3) Even if the bureau is correct in increasing the petitioner's entire net income, the bureau has erred in calculating the credit to which the petitioner is entitled under Section 210(13)(a) of the Tax Law by limiting eligibility for such credit to income attributable to shipments from a regular place of business in New York.

(4) The petitioner further asserts that it is entitled to refunds of $167,618 for 1972 and $74,881 for 1973, representing the tax paid by the petitioner with respect to the deemed distributions by DISC for such years, plus interest.

Attached as Exhibit A is a statement setting forth the basis for the relief sought by the petitioner.

No other action has heretofore been commenced before the State Tax Commission in respect to any of the items herein before stated, nor has any relief been previously granted in respect thereto.

WHEREFORE, the petitioner prays that (13) the notices of deficiencies in the franchise tax on business corporations be cancelled for the years 1972 and 1973 and that refunds of taxes paid for such years be granted and respectfully demands that this petition be granted.

This statement is made with the knowledge that a willfully false representation is a misdemeanor punishable under section 210.45 of the Penal Law.

Sept. 20, 1977
Date

/s/ Henry W. de Koenian * *
Signature of Taxpayer or Representative*

*NOTE: If the petition is signed by any person other than the taxpayer, it must be accompanied by a duly executed power of a attorney unless either (1) a power of attorney has already been filed, or (2) the taxpayer is a minor whose return was filed by the signing the petition or is mentally or physically incapable of signing.

** A Power of Attorney authorizing the signer to represent the petitioner has already been filed.

THE PERFECTED PETITION AND 3 CONFORMED COPIES ARE REQUIRED PURSUANT TO SECTION 601.5(a) OF THE RULES

(1) Insert names of petitioner or petitioners.

(2) Insert the subject matter from the following list which is applicable to your petition:

a. For personal income tax (Article 22) or unincorporated business tax (Article 23) or both of these taxes; for the franchise tax on business corporations (Article 9-A), the tax on unrelated business income (Article 13), the gift tax (Article 26-A) the franchise tax on banking corporations (Article 32) and the franchise taxes on insurance corporations (Article 33), insert the following:

Redetermination of a Deficiency or for Refund of (specify tax or taxes involved) under Article (specify Article or Articles of the Tax Law) of the Tax Law for the Year (insert year or years involved).

b. For sales and compensating use tax (Articles 28 and 29), for the tax on transfers of stock and other corporate certificates (Article 12) for tax on gasoline and similar motor fuel (Article 12-A), for taxes on alcoholic beverages (Article 18), for tax on cigarettes (Article 20), for highway use tax (Article 21) insert the following:

Review of a Determination of Tax Due or for Refund of (specify tax or taxes) under Article (insert appropriate Article number or numbers) of the Tax Law for (insert period or periods involved)

c. For Tax on Mortgages (Article 11) insert the following:

Review of a Determination under Article 11 of the Tax Law, Tax on Mortgages, with reference to an instrument recorded (insert date instrument was recorded)

d. Where the petition involves licenses or permits under an Article of the Tax Law, insert the following:

Review of a Refusal to Issue or Denial, Revocation or Suspension of a license or permit under Article (insert appropriate Article number) of the Tax Law.

(3) Insert social security number, employer identification number or a number assigned by the Department of Taxation and Finance to the taxpayer. Do not use a file number.

(4) Insert address shown on tax return and state present address, if different.

(5) Insert matter included in caption, (2) above, specifically identifying the action e.g. refund or license renewal or redetermination of a deficiency.

(6) Insert action taken by operating bureau e.g. redetermination of deficiency, denial of refund.

(7) Insert Article & tax e.g. Article 22, Personal Income Tax.

(8) Insert date contained on notice.

(9) Insert operating bureau e.g. Income Tax Bureau.

(10) Insert in the appropriate columns the indicated information. Where the controversy involves a refund, the amount claimed should be inserted in parentheses e.g. ($375.16). Where the controversy does not involve taxes or penalties, type a brief statement of the subject across the columns for figures e.g. license as a wholesale dealer in cigarettes denied.

(11) Insert specific operating bureau.

(12) In separately numbered paragraphs, list each error of the operating bureau which the petitioner intends to prove.

Thereafter, in separately numbered paragraphs state the facts petitioner intends to prove at the hearing to establish the operating bureau's errors and to provide a basis for the relief sought by petitioner. (It is not necessary to state the evidence petitioner intends to offer in proof of the facts alleged.) Where necessary, additional pages may be added.

(13) Set forth the relief desired e.g. the notice of deficiency for personal income taxes be cancelled for tax years 1967 and 1968.

SERVICE OF THE PERFECTED PETITION AND 3 CONFORMED COPIES MUST BE MADE ON THE:

SECRETARY TO THE STATE TAX COMMISSION
P.O. BOX 5038

Exhibit A to
Westinghouse Electric Corporation
Petition for Redetermination of
Deficiencies in the New York State
Franchise Tax on Business Corporations
Under Article 9-A of the Tax Law
For the Years 1972 and 1973

(1) The petitioner, Westinghouse Electric Corporation ("Westinghouse"), a Pennsylvania corporation, owns all of the stock of Westinghouse Electric Export Corporation, a Delaware corporation ("DISC"). During 1972 and 1973, DISC qualified under Section 992(a) of the Internal Revenue Code of 1954 (the "Code") and was exempt from Federal income tax for such years under Section 991 of the Code. All of DISC's business income for 1972 and 1973 consisted of sales commissions derived from export sales of products manufactured by Westinghouse and other affiliated companies. It reported taxable income on Federal Form 1120-DISC for 1972 and 1973 in the amounts of $25,987,000 and $57,948,738, respectively.

(2) DISC did not make any *actual* distributions to Westinghouse in 1972. It *actually* distributed $10,068,500 to Westinghouse in 1973, all of which was treated as made out of previously taxed income under Section 996(a)(1) of the Code. $12,956,500 of DISC's taxable income for 1972 and $29,838,006 of its taxable income for 1973 was *deemed* distributed by DISC to Westinghouse in 1972 and 1973, respectively, under Section 995(b) of the Code and Westinghouse included these respective amounts in its Federal gross income for 1972 and 1973. Federal taxation of the remainder of DISC's taxable income for 1972 and 1973 (the "accumulated DISC income") was deferred under the DISC provisions of the Code.

(3) During 1972 and 1973, DISC did not engage in any business activities in New York, nor did it employ capital, own or lease property, or maintain an office in the State at any time during such years. DISC did not file a New York corporate

franchise tax return for either 1972 or 1973 because it was not subject to New York jurisdiction.

(4) Westinghouse filed Form CT-3 with the State of New York for 1972 and 1973 as a Pennsylvania corporation doing business in New York. Its reported entire net income for 1972 and 1973 was $136,516,711 and $43,715,850, respectively, which included the $12,956,500 and $29,838,006 deemed distributions from DISC for the respective years but did not include any portion of DISC's accumulated DISC income for such years. The deemed distributions were allocated to New York according to Westinghouse's business allocation percentages of 6.387743% for 1972 and 6.239516% for 1973, respectively, computed without regard to such deemed distributions.

(5) In separate Notices of Deficiency dated June 15, 1976, the Corporation Tax Bureau of the Department of Taxation and Finance alleged deficiencies in Westinghouse's corporate franchise tax of $73,970.23 for 1972 and $151,436.76 for 1973. The entire amount of the alleged deficiencies relates to Westinghouse's treatment of the taxable income of DISC for 1972 and 1973 on Westinghouse's own returns.

(6) Since more than 5% of DISC's gross receipts in both 1972 and 1973 consisted of sales commissions from Westinghouse, DISC would have been exempt from New York franchise tax under Section 208(9)(i)(A) of Chapter 60, Article 9-A of the New York Tax Law (the "Tax Law") even if New York had jurisdiction to subject it to tax. It is therefore alleged in the Notices of Deficiency that Westinghouse is required under Section 208(9)(i)(B) of the Tax Law to consolidate DISC's receipts, expenses, assets and liabilities with its own in computing its New York income tax liability, excluding all transactions between Westinghouse and DISC.

(7) Since Westinghouse only included the deemed distributions from DISC for 1972 and 1973, and not the DISC's accumulated DISC income for such years, in its own entire net income for 1972 and 1973, it is proposed in the Notices that

Westinghouse's entire net income for 1972 be increased by $13,390,500* from $136,516,711 to $149,907,211 and that its entire net income for 1973 be increased by $28,110,732 from $43,715,850 to $71,826,582. In addition, it is proposed in the Notices that the receipts factors used to compute Westinghouse's business allocation percentages for 1972 and 1973 be recomputed by adding DISC's commission income derived from customers other than Westinghouse for such years to the denominator of such factors, but not to the numerator, thus reducing Westinghouse's receipts factor for 1972 from 5.945712% as reported on its 1972 return, to 5.935845% and reducing its receipts factor for 1973 from 5.665182%, as reported on its 1973 return, to 5.650114%. This would reduce Westinghouse's business allocation percentage for 1972 from 6.387743% to 6.384454% and that for 1973 from 6.239516% to 6.234494%. The net effect of the two proposed adjustments for 1972 described above would be to increase Westinghouse's business income for 1972 allocable to New York from $8,683,334 to $9,533,778, an increase of $850,444, with a resulting deficiency in tax for 1972 of $76,539.96. Similarly, the net effect of the two proposed adjustments for 1973 described above would be to increase Westinghouse's business income for 1973 allocable to New York from $2,702,912 to $4,453,304, an increase of $1,750,392, with a resulting deficiency in tax for 1973 of $157,535.28.

(8) It is proposed in the Notices of Deficiency, however, that Westinghouse be allowed credits under Section 210(13)(a) of the Tax Law in the respective amounts of $2,569.77 and $6,098.22 for 1972 and 1973. Such credits were computed by first multiplying $13,390,500 and $28,110,732,

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* The auditor made an error in calculating this adjustment for 1972. The DISC's taxable income for 1972 was $25,987,000, from which the auditor subtracted $12,596,500 as the deemed dividend already included in Westinghouse's entire net income for 1972, to arrive at an adjustment of $13,390,500. In fact, DISC's deemed distributions included in Westinghouse's entire net income for such year totaled $12,956,500. Therefore, under the auditor's theory, Westinghouse's entire net income should only have been increased by $13,030,500 for 1972.

representing the DISC's accumulated DISC income for 1972 and 1973 respectively, as computed by the auditor,* by 4.771297% and 5.523182%, respectively, those being the percentages of Westinghouse's receipts from export property on which DISC earned a sales commission and which was shipped from a regular place of business of Westinghouse in New York as compared to Westinghouse's total receipts on the sale of export property for such years for which DISC received a sales commission.

(9) The respective products, $638,901 for 1972 and $1,552,607 for 1973, were then multiplied by Westinghouse's revised business allocation percentages for the respective years, with the result that of the $13,390,500 and $28,110,732 alleged to be includible in Westinghouse's entire net income for 1972 and 1973, respectively, only $40,790 and $96,797 respectively, was found to be eligible for credit under Section 210(13)(a). These amounts were then multiplied first by 70% and then by the 9% rate of tax in effect for 1972 and 1973 to arrive at credits of $2,569.77 and $6,098.22 for 1972 and 1973, respectively.

(10) It is Westinghouse's contention that the entire alleged deficiencies for 1972 and 1973 are erroneous on the ground that the proposed application of Section 208(9)(i)(B) of the Tax Law would violate the due process clauses of Article 1, Section 6 of the New York State Constitution and the Fourteenth Amendment to the United States Constitution in that New York lacked a jurisdictional nexus upon which to subject DISC's income to tax, and would impose an undue burden on interstate and foreign commerce in violation of Article I, Section 8, of the United States Constitution.

(11) Alternatively, even if DISC's income could properly be taxed by New York, Westinghouse contends that the proposed increase in Westinghouse's entire net income for 1972 by $13,390,500 is erroneous in part since all but $13,030,500 of DISC's taxable income for 1972 was already included in

* In fact, the DISC's accumulated DISC income for 1972 was $13,030,500, rather than $13,390,500.

Westinghouse's entire net income for such year as reported. The auditor's proposed increase in Westinghouse's entire net income is thus $360,000 too high. Of this amount, $22,984.03 was allocated by the auditor to New York, using a business allocation percentage of 6.384454%. As a result, the amount of the alleged tax deficiency for 1972 is overstated by $2,068.56.

(12) In addition, Westinghouse contends that even if DISC's income could properly be taxed by New York, all of DISC's accumulated DISC income for 1972 and 1973 allocable to New York upon which Westinghouse is deemed subject to tax must be eligible for the credit under Section 210(13)(a) of the Tax Law. Section 210(13)(a), in limiting eligibility for credit thereunder to such income attributable to shipments from a regular place of business in New York, violates the New York State and United States Constitutions in the following respects:

> (a) it discriminates against taxpayers who do not have a regular place of business in New York, or whose shipments of export property are made principally from outside the State, in violation of the equal protection and due process clauses of Article 1, Sections 6 and 11 of the New York State Constitution and the Fourteenth Amendment to the United States Constitution; and
>
> (b) by granting a credit only with respect to shipments from a regular place of business in New York, Section 210(13)(a) deters taxpayers from making shipments of export property from locations outside the State by placing those who do at a competitive disadvantage, and thus imposes an undue burden on the free flow of both interstate and foreign commerce in violation of Article I, Section 8 of the United States Constitution.

(13) $831,926.28 of DISC's accumulated DISC income for 1972, and $1,752,561.90 of such income for 1973, would be allocable to New York using the business allocation percentages of 6.384454% for 1972 and 6.234494% for 1973 as computed in the Notices of Deficiency. The respective credits under Section 210(13)(a) computed on the basis of these amounts would be $52,411.36 for 1972 and $110,411.40 for 1973. The auditor should therefore have allowed Westinghouse additional credits of $49,841.59 and $104,313.18 for

1972 and 1973 respectively and, as a result of his failure to do so, the alleged deficiencies in Westinghouse's tax for such years are overstated by such amounts.

(14) Further, it is Westinghouse's contention that it is entitled to refunds of $167,618 and $74,851, for 1972 and 1973, representing the tax paid by Westinghouse with respect to the deemed distributions by DISC for such years, plus interest, on the ground that since dividends derived from subsidiary capital are generally not subject to tax in New York, the State may not tax actual or deemed dividend distributions of subsidiaries engaged in export activities differently from dividends of all other subsidiaries. To do so would constitute a violation of the equal protection clauses of Article 1, Section 2 of the New York State Constitution and the Fourteenth Amendment to the United States Constitution and would impose an undue burden on foreign commerce in violation of Article I, Section 8 of the United States Constitution.

In the Matter of the Petition

of

WESTINGHOUSE ELECTRIC CORPORATION **ANSWER**

for Redetermination of Deficiency in Franchise Tax on Business Corporations Under Article 9A of the Tax Law for the Years 1972 and 1973.

The Department of Taxation and Finance as and for its answer to the taxpayer's perfected petition states the following:

A. The Department of Taxation and Finance denies:

1. That it was erroneous to include in petitioner's entire net income certain income from Westinghouse Electric Corporation ("DISC").

2. That the Bureau erred in calculating the credit the petitioner was entitled to under section 210(13)(a) of the Tax Law by limiting eligibility for such credit to income attributable to shipments from a regular place of business in New York.

3. That the petitioner is entitled to a refund of $167,618 for 1972 and $74,851 for 1973, representing the tax paid by petitioner with respect to deemed distributions by Westinghouse Electric Export Corporation for such years, plus interest.

4. That the DISC was not subject to New York jurisdiction, at least as far as requiring it to be consolidated with its parent for tax purposes.

5. All of the taxpayer's claims of unconstitutionality as to various parts of the Tax Law in regard to the taxation of a DISC.

6. That the taxpayer is entitled to additional credits under section 210(13)(a) of $49,841.59 for 1972 and $104,313.18 for 1973 for DISC's sales not shipped from the taxpayer's regular place of business in New York.

B. The Department of Taxation and Finance admits that the Department of Taxation and Finance erred in using the amount of $12,596,500 as the deemed dividend instead of the actual deemed dividend of $12,956,500 for the year 1972.

C. The Department of Taxation and Finance affirmatively states the following:

1. That the tax due for 1972 should be $71,970, due to the transposition of numbers admitted above by the auditors in the deemed dividend.

2. That the Tax Law is presumed constitutional in administrative hearings.

WHEREFORE, the Department of Taxation and Finance asks that the petition be denied except to the extent of the errors admitted above, the notice of determination be affirmed as modified for the year 1972 as requested above.

/s/.....
Deputy Counsel

Albany, New York
Dated: November 7, 1977

STATE OF NEW YORK
DEPARTMENT OF TAXATION AND FINANCE
STATE TAX COMMISSION

In the Matter of the Petition

of

WESTINGHOUSE ELECTRIC CORPORATION

for a Redetermination of a Deficiency or for Refund of Corporation Franchise Taxes under Article 9A of the Tax Law for the Years 1972 and 1973.

APPEARANCES:

FOR THE TAXPAYER:
CRAVATH, SWAINE & MOORE, ESQS.
One Chase Manhattan Plaza
New York, New York 10005
BY: HENRY W. DE[K]OSMIAN, ESQ.
—and—
PATRICIA GEOGHEGAN,
Of Counsel

FOR THE CORPORATION TAX BUREAU:
PETER J. CROTTY, JR., ESQ.
Counsel, Department of Taxation and Finance
State Campus
Albany, New York 12227
BY: JAMES MORRIS, ESQ.,
Of Counsel

FOR THE STATE TAX COMMISSION:
JULIUS BRAUN, ESQ.
Hearing Officer

FORMAL HEARING held at the offices of the State Tax Commission, Two World Trade Center, New York, New York, on Wednesday, January 18, 1978, at 1:15 P.M.

[2] THE HEARING OFFICER: This is a formal hearing in the matter of Westinghouse Electric Corporation for a redetermination of a deficiency or for refund of corporation franchise taxes under Article 9A of the Tax Law for the Years 1972 and 1973.

Now, sir, this is the procedure we will follow:

The Tax Bureau will put into evidence what is known as the jurisdictional papers in this case. This is done so we know what the issues are before us.

After that, you, the petitioner, may present sworn testimony and documentary material in support of your petition.

Any witness testifying is, of course, subject to cross-examination.

Following that, the Tax Bureau may present such witnesses as it desires in support of its position.

In connection with the presentation of your case, I wish to remind you of two factors. First the burden of proof is upon the petitioner; second, at prior formal or [3] informal conferences or by mail you may have submitted documentary materials to the Tax Bureau. If you wish them to be considered by the State Tax Commission at this hearing, you must introduce them into evidence.

At the conclusion of testimony each side may have brief argument as to law and facts, and you may file formal briefs after you receive the record of this hearing. Let me know at the conclusion of this hearing.

The Corporation Tax Bureau may proceed.

MR. MORRIS: I offer as my first exhibit, copies of notice of deficiencies corporation tax due for the period ended 12/31/72 and 12/31/73.

MR. DE KOSMIAN: No objection.

THE HEARING OFFICER: It will be received and marked Department's Exhibit A.

MR. MORRIS: I offer collectively as the second exhibit, the statement of audit adjustments for the years 12/31/72, 12/31/73; the audit adjustments are annexed to the corporate returns; franchise tax reports of Westinghouse Electric Corporation [4] for the same years.

MR. DE KOSMIAN: I have no objection.

THE HEARING OFFICER: The statement of audit adjustments together with the franchise tax reports for the period in issue will be received as Department's Exhibit B in evidence.

MR. MORRIS: I offer collectively as my next exhibit, petition of Westinghouse Electric Corporation, the perfected petition of Westinghouse Electric Corporation, and the answer of the Department of Taxation and Finance to the perfected petition.

MR. DE KOSMIAN: No objection.

THE HEARING OFFICER: We will mark the petition as Department's Exhibit C in evidence.

The perfected petition will be marked as Exhibit D.

The answer will be marked as Department's Exhibit E in evidence.

MR. MORRIS: I offer as my next exhibit, field audit report of Westinghouse Electric Corporation, again covering the same [5] subject years, 1972 and 1973, and annexed thereto is supporting schedules A, B, C and D.

THE HEARING OFFICER: The field audit report and the attachments as described by Mr. Morris will be received as Department's Exhibit F in evidence.

MR. MORRIS: I offer as my next exhibit, a power of attorney giving the power to the representatives here today

from the corporation to represent them before the State Tax Commission.

MR. DE KOSMIAN: No objection.

THE HEARING OFFICER: The power of attorney is received in evidence as Department's Exhibit G.

MR. MORRIS: I offer as my next exhibit, a stipulation of facts from the representative of the taxpayer and for the Department of Taxation and Finance. It's signed by Mr. De Kosmian, counsellor for the petitioner, and signed by Mr. Art Rosen, deputy counsel for the Department of Taxation and Finance; annexed thereto is a [6] carbon letter which sets forth our agreement as to documents which I will provide today at the hearing.

THE HEARING OFFICER: Did you?

MR. MORRIS: I have so provided, yes, Mr. Hearing Officer.

THE HEARING OFFICER: The stipulation is received in evidence and marked as Department's Exhibit H.

MR. MORRIS: That concludes the introduction of the jurisdictional documents.

THE HEARING OFFICER: What is the issue?

MR. MORRIS: The issue as the Department sees it concerns a reporting of income from DISC under Section 208.9-i(a) and (b) of the Tax Law.

It's the Department's position that in the audit performed that they properly applied Section 208.9 and required the taxpayer to file on a consolidated basis the taxpayer Westinghouse Electric with their DISC corporation and include the income thereon on a consolidated basis.

[7] The taxpayer argues that our statutory scheme is unconstitutional—

THE HEARING OFFICER: He will state his own position.

What is the relationship between DISC and the petitioner, Westinghouse Electric Corporation?

MR. DE KOSMIAN: The DISC was a subsidiary, a wholly owned subsidiary of Westinghouse Electric Corporation. The DISC's name, if you want it for the record, was Westinghouse Electric Export Corporation.

THE HEARING OFFICER: Do you want to present anything at this hearing?

MR. DE KOSMIAN: Basically, we are attacking the constitutionality of the New York State franchise tax on business corporations as applied to DISC's. I think all of the facts have been fully stipulated and are also reflected in the other documents that have just been introduced into evidence.

Just for the record, I might say that the DISC acted as commission agent in connection with export sales for Westinghouse [8] Electric Corporation and various affiliates of Westinghouse Electric Corporation, and it received a commission from Westinghouse Electric Corporation or its affiliates, as the case might be, with respect to export sales that those corporations made for these particular years 1972 and 1973.

Under the New York statute a DISC is exempt from New York franchise tax, but all of its income is taxed to the parent corporation, in this case Westinghouse Electric Corporation.

Our basic contention is that this is an unconstitutional provision and that there is no authority to tax Westinghouse Electric Corporation on the income of the DISC. The DISC itself, as has been stipulated, was not engaged in business in New York, had no offices here, had nothing here.

That is our basic contention.

We have a number of alternative arguments which are set forth in the petition, in the perfected petition. I don't know whether you want me to summarize the [9] alternative arguments that we are making.

THE HEARING OFFICER: Put that in a brief.

MR. DE KOSMIAN: I think they are all reflected in the papers that have already been filed.

THE HEARING OFFICER: If you wish to file a brief 30 days from now, you may. If you want more time you can request the same and you will have an additional amount of time for reply brief.

MR. MORRIS: I would like to mention for the record, it is within the stipulation and within the department's answer that there was a transposition of figures upon audit, where the auditor transposed two numbers, and that we have stipulated, and both in the stipulation of facts and the answer that the figures on the notice of deficiency are in error and that the basic tax due were the taxpayer to lose, the figures are in error from the figures asserted on the notice of deficiency in the statement of audit changes.

[10] MR. DE KOSMIAN: Right, that is correct. That was a mathematical error that the auditor made, a transposition error.

I don't know whether what I am about to say now requires any further filing of documents or whether I can just put it in the record here. But I would like to say that in our perfected petition, and I think also in the original petition we are claiming refunds of taxes paid by Westinghouse Electric Corporation for 1972 and 1973.

Those figures, assuming we are right in that contention, were unfortunately transposed, the amount we are claiming for '72 should have been claimed for '73 and vice versa. That appears on the second page of the perfected petition, paragraph 4, where we assert a refund of $167,618 for 1972, and $74,851 for 1973. That was a

transposition error and it should be the opposite; the lower figure for '72 and the higher figure for '73.

I think that's sufficient.

I might add, that because of the fact [11] that we are making various alternative arguments in addition to our basic argument, it would be very difficult without making seven or eight different alternative computations to determine what the correct amount of the refund or deficiency might be, depending on how those various arguments are resolved.

Therefore, we have stipulated that when there is an ultimate resolution on the merits, then we will calculate the refunds and deficiencies.

MR. MORRIS: Depending on the different alternatives that may be allowed or disallowed, that the operating bureau could calculate the correct amount is due and owing either to the State or to the taxpayer based upon the determinations to be made on the law and it is so stated in the stipulation.

THE HEARING OFFICER: Are the remarks made by counsel in the stipulation as to the error in the transposition?

MR. MORRIS: I am not sure whether that is in the stipulation.

[12] THE HEARING OFFICER: Do you know, counsellor?

MR. DE KOSMIAN: That is not.

THE HEARING OFFICER: It's in the record. Is there anything else?

MR. DE KOSMIAN: There is one other point I would like to make.

We have an additional alternative argument that we would like to make, which was not reflected in our petition.

And I don't know whether you want me to amend the petition or not.

It doesn't involve the introduction of any new facts, it's simply an alternative argument. That argument is basically as follows:

As I mentioned earlier, the DISC, Westinghouse Electric Export Corporation, got commission income from Westinghouse Electric Corporation, the taxpayer in this proceeding, in respect of sales, export sales made by Westinghouse Electric Corporation.

In addition, the DISC got commissions from export sales made by various affiliates [13] of Westinghouse Electric Corporation in respect of export sales made by those affiliates.

The State has allocated to Westinghouse Electric Corporation, the taxpayer in this proceeding, all of the commission income of the DISC, including the commission income of the DISC in respect of sales made by affiliates of Westinghouse and paid by those affiliates.

It has been stipulated, I believe, that none of those affiliates were engaged in business in New York or subject to the jurisdiction of New York.

We would like to make the additional argument, which, of course, is irrelevant if we prevail on our basic argument, that even if it is proper to allocate to Westinghouse Electric Corporation the commissions which the DISC received from Westinghouse Electric Corporation in respect of export sales made by it, that even if that is proper, which we of course contend [14] is not, that it is nevertheless improper to allocate to Westinghouse Electric Corporation the commissions which the DISC earned from export sales made by the affiliates of Westinghouse Electric Corporation.

That argument was not made in our petition. I think all of the facts necessary to support the argument are contained in the documents that have been filed.

I don't know whether you want me to make a formal motion to amend our petition to make—

THE HEARING OFFICER: No, you have made it on the record.

MR. DE KOSMIAN: That's all I wanted to know.

THE HEARING OFFICER: Do you want to say anything?

MR. MORRIS: No, Mr. Hearing Officer.

THE HEARING OFFICER: All right. 30 days or 45 days, with that reasonable time, to file a brief after receipt of the record.

This hearing is closed.

EXHIBITS

Department's		In Evid.
A	Copies of notice of deficiencies for periods ended December 31, 1972 and December 31, 1973	3
B	Statement of audit adjustments for the years December 31, 1972 and December 31, 1973, together with franchise tax reports	4
C	Petition	4
D	Perfected petition	4
E	Answer	E
F	Field audit report and attachments	5
G	Power of attorney	5
H	Stipulation of facts	6

DECISION OF THE STATE TAX COMMISSION

STATE OF NEW YORK
STATE TAX COMMISSION

In the Matter of the Petition

of

WESTINGHOUSE ELECTRIC CORPORATION

for Redetermination of a Deficiency or for Refund of Franchise Tax on a Business Corporation under Article 9-A of the Tax Law for the Years 1972 and 1973.

DECISION

Petitioner, Westinghouse Electric Corporation, Gateway Center, Pittsburgh, Pennsylvania 15225, filed a petition for redetermination of a deficiency or for refund of franchise tax on a business corporation under Article 9-A of the Tax Law for the years 1972 and 1973 (File No. 17433).

A formal hearing was held before Julius E. Braun, Hearing Officer, at the offices of the State Tax Commission, Two World Trade Center, New York, New York, on January 18, 1978 at 1:15 P.M. Petitioner appeared by Cravath, Swaine and Moore, Esqs. (Henry W. DeKosmian, Esq. and Patricia Geoghegan, Esq., of counsel). The Corporation Tax Bureau appeared by Peter Crotty, Esq. (James Morris, Esq., of counsel).

ISSUE

Whether section 208.9(i)(B) of the Tax Law which required petitioner to consolidate the receipts, expenses, assets and liabilities of its wholly owned subsidiary, Westinghouse Electric Export Corporation (a "DISC" corporation), with its own, in computing its New York income tax liability, is constitutional.

FINDINGS OF FACT

1. On June 15, 1976 pursuant to a field audit, the Corporation Tax Bureau issued a Statement of Audit Adjustment to petitioner, Westinghouse Electric Corporation, for the periods ending December 31, 1972 and December 31, 1973, assessing additional tax. Accordingly, a Notice of Deficiency was issued on the same day for $73,970.23, plus interest of $18,026.55, for a total of $91,996.78, for the period ending December 31, 1972, and $151,436.76, plus interest of $25,547.38, for a total of $176,984.14 for the period ending December 31, 1973. Due to the transposition of numbers by the auditor, the tax due should be $71,970.00, plus interest, for the period ending December 31, 1972.

2. Petitioner, Westinghouse Electric Corporation, and the Corporation Tax Bureau stipulated and agreed as follows:

a. Petitioner, Westinghouse Electric Corporation ("Westinghouse"), is a Pennsylvania corporation which does business in New York State.

b. Westinghouse Electric Export Corporation ("DISC") is a Delaware corporation which elected to be treated as a domestic international sales organization for Federal income tax purposes and was so treated for the years 1972 and 1973.

c. Westinghouse owns all the stock of DISC.

d. Westinghouse and DISC keep their records on the accrual method of accounting.

e. During 1972 and 1973, DISC qualified under Section 992(a) of the Internal Revenue Code of 1954 (the "Code") and was exempt from Federal income tax for such years under Section 991 of the Code.

f. DISC was commission agent for Westinghouse and affiliated companies in respect of export sales of property and related services. All of DISC's business income for 1972 and 1973 consisted of commissions paid it in respect of

export sales of products and related services by Westinghouse and other affiliated companies.

g. DISC reported total income on Federal Form 1120-DISC for 1972 and 1973 in the amounts of $25,987,000 and $57,948,738, respectively. Of DISC's total 1972 income, $19,888,000 was received from Westinghouse and $6,099,000 was received from other affiliated companies not doing business in New York State.

h. DISC did not make any distributions to Westinghouse in 1972. DISC distributed $10,068,500 to Westinghouse in 1973, all of which was treated as made out of previously taxed income under Section 996(a)(1) of the Code.

i. $12,956,500 of DISC's total income for 1972 and $29,838,006 of its taxable income for 1973 was deemed distributed by DISC to Westinghouse in 1972 and 1973, respectively, under Section 995(b) of the Code and Westinghouse included those amounts in its Federal gross income for 1972 and 1973. Federal taxation of the remainder of DISC's total income for 1972 and 1973 (the "accumulated DISC income") was deferred under the DISC provisions of the Code.

j. During 1972 and 1973, DISC had no paid employees, did not engage in any business activities in New York, nor did it employ capital, own or lease real or tangible personal property, pay real estate rentals, or maintain an office in New York State at any time during such years.

k. DISC did not file a New York corporate franchise tax return for either 1972 or 1973 because it and Westinghouse take the position that DISC was not subject to New York jurisdiction.

l. Westinghouse filed Form CT-3 with the State of New York for 1972 and 1973 as a Pennsylvania corporation doing business in New York. Its reported entire net income for 1972 and 1973 was $136,516,711 and

$43,715,850, respectively, which included the $12,956,500 and $29,838,006 deemed distributions from DISC for those years but did not include any portion of DISC's accumulated DISC income for such years. The deemed distributions were allocated to New York according to Westinghouse's business allocation percentages of 6.387743% for 1972 and 6.239516% for 1973, computed without regard to such deemed distributions.

m. In separate Notices of Deficiency dated June 15, 1976, the Corporation Tax Bureau of the Department of Taxation and Finance alleged deficiencies in Westinghouse's corporate franchise tax of $73,970.23 for 1972 and $151,436.76 for 1973.

n. The entire amount of the alleged deficiencies relates to Westinghouse's treatment of the total income of DISC for 1972 and 1973 on Westinghouse's own returns.

o. The alleged deficiencies were computed as follows:

(1) Because more than 5% of DISC's gross receipts in both 1972 and 1973 consisted of sales commissions from Westinghouse, DISC would have been exempt from New York franchise tax under Section 208.9(i)(A) of Chapter 60, Article 9-A of the New York Tax Law whether or not New York otherwise had jurisdiction to subject it to tax. It is therefore alleged in the Notices of Deficiency that Westinghouse is required under Section 208.9(i)(B) of the Tax Law to consolidate DISC's receipts, expenses, assets and liabilities with its own in computing its New York income tax liability, excluding all transactions between Westinghouse and DISC.

(2) Since Westinghouse only included the deemed distributions from DISC for 1972 and 1973, and not the DISC's accumulated DISC income for such years, in its own entire net income for 1972 and 1973, it is proposed in the Notices of Deficiency that

Westinghouse's entire net income for 1972 be increased by $13,390,500 from $136,516,711 to $149,907,211 and that its entire net income for 1973 be increased by $28,110,732 from $43,715,850 to $71,826,582. In addition, it is proposed in the Notices of Deficiency that the receipts factors used to compute Westinghouse's business allocation percentages for 1972 and 1973 be recomputed by adding DISC's commission income derived from customers other than Westinghouse (which other customers did not do business in New York and were not subject to New York tax) for such years to the denominator of such factors, but not to the numerator, thus reducing Westinghouse's receipts factor for 1972 from 5.945712% as reported on its 1972 return, to 5.935845% and reducing its receipts factor for 1973 from 5.665182%, as reported on its 1973 return, to 5.650114%. Such a calculation results in a reduction of Westinghouse's business allocation percentage for 1972 from 6.387743% to 6.384454% and for 1973 from 6.239516% to 6.234494%. The net effect of the two proposed adjustments for 1972 described above increased Westinghouse's business income for 1972 allocable to New York from $8,683,334 to $9,533,778, an increase of $580,444, with a resulting deficiency in tax for 1972 of $76,539.96. Similarly, the net effect of the two proposed adjustments for 1973 described above increased Westinghouse's business income for 1973 allocable to New York from $2,702,912 to $4,453,304, an increase of $1,750,392, with a resulting deficiency in tax for 1973 of $157,535.28.

(3) It is proposed in the Notice of Deficiency, however, that Westinghouse be allowed credits under Section 210(13)(a) of the Tax Law in the respective amounts of $2,569.77 and $6,098.22 for 1972 and 1973. Such credits were computed by first multiplying $13,390,500 and $28,110,732, representing the DISC's accumulated DISC income for 1972 and 1973

respectively, as computed by the auditor, by 4.771297% and 5.523182%, respectively, those being the percentages of Westinghouse's receipts from export property on which DISC earned a sales commission and which was shipped from a regular place of business of Westinghouse in New York as compared to Westinghouse's total receipts on the sale of export property for such years for which DISC received a sales commission. Such total receipts amounted to $223,587,000 in 1972 and $408,080,000 in 1973.

(4) The respective products, $638,901 for 1972 and $1,552,607 for 1973, were then multiplied by Westinghouse's revised business allocation percentages for the respective years, with the result that of the $13,390,500 and $28,110,732 alleged to be includable in Westinghouse's entire net income for 1972 and 1973, respectively, only $40,790 and $96,797 respectively, was found to be eligible for credit under Section 210(13)(a). These amounts were then multiplied first by 70% and then by the 9% rate of tax in effect for 1972 and 1973 to arrive at credits of $2,569.77 and $6,098.22 for 1972 and 1973, respectively.

p. Westinghouse paid franchise tax under Article 9-A of the Tax Law in the amounts of $749,384 and $205,548, respectively, for 1972 and 1973. The taxes so paid by Westinghouse reflected the inclusion in its business income for 1972 and 1973 of the deemed distributions in the amounts of $12,956,500 and $29,838,006 for 1972 and 1973, respectively.

q. With respect to Westinghouse's assignment of error number 2 of the Perfected Petition, the Department of Taxation and Finance for the State of New York concedes that the proposed increase in Westinghouse's entire net income for 1972 under the State's theory should be $13,030,500 rather than $13,390,500 and that therefore the proposed deficiency for 1972 is $71,970.

r. The parties agree to reserve the calculation of the amount of any deficiency or refund until ultimate resolution of the issues raised in Westinghouse's petition.

s. The petition in this action was timely filed on September 10, 1976.

CONCLUSIONS OF LAW

A. That the constitutionality of the laws of the State of New York is presumed at the administrative level. Accordingly, the State Tax Commission does not have jurisdiction to declare such laws unconstitutional and it must be presumed that section 208.9(i)(B) of the Tax Law is constitutional to the extent that it relates to the imposition of the tax which is the subject of this proceeding.

B. That the petition of Westinghouse Electric Corporation is denied and the notices of deficiency issued June 15, 1976, are sustained.

DATED: Albany, New York
August 31, 1979

STATE TAX COMMISSION

/s/ JAMES H. TULLY, JR.
President

/s/ MILTON KOERNER
Commissioner

/s/ THOMAS H. LYNCH
Commissioner

ORDER OF THE NEW YORK SUPREME COURT

At a Special Term of the Supreme Court of the State of New York, held in and for the County of Albany, at the Courthouse, in the City of Albany, New York, on the 25th day of January, 1980.

PRESENT:

Hon. EDWARD S. CONWAY,
Justice.

In the Matter of the Application of
WESTINGHOUSE ELECTRIC CORPORATION,
Petitioner,

For a Judgment Pursuant to Article 78 of the Civil Practice Law and Rules
—against—

JAMES H. TULLY, JR., MILTON KOERNER and THOMAS H. LYNCH, as the Tax Commission of the State of New York,
Respondents.

ORDER

Index No. 11313-79

Upon reading and filing the notice of petition and petition of Westinghouse Electric Corporation, verified the 18th day of December, 1979, and the answer and return of the respondents, verified the 10th day of January, 1980, and it appearing that one of the issues involved is whether the determination of the respondents made as a result of a hearing and at which evidence was taken pursuant to direction by law is, on the entire record, supported by substantial evidence, and due deliberation having been had,

Now, upon motion of Robert Abrams, Attorney General of the State of New York, attorney for respondents, it is

ORDERED, that pursuant to section 7804(g) of the Civil Practice Law and Rules, the above-entitled proceeding be and the same hereby is transferred to the Appellate Division of the Supreme Court, Third Judicial Department, for disposition.

Dated: Albany, New York
January 25, 1980

/s/ EDWARD S. CONWAY
J.S.C.

ENTER:

DECISION OF THE APPELLATE DIVISION, SUPREME COURT OF THE STATE OF NEW YORK, THIRD JUDICIAL DEPARTMENT

June 18, 1981 No. 39582

In the Matter of WESTINGHOUSE ELECTRIC CORPORATION,
Petitioner,

v.

JAMES H. TULLY, JR., et al., Constituting the Tax Commission of the State of New York,
Respondents.

Proceeding pursuant to CPLR article 78 (transferred to this court by order of the Supreme Court at Special Term, entered in Albany County) to review a determination of the State Tax Commission, which sustained corporate franchise tax assessments imposed pursuant to article 9-A of the Tax Law.

The principal issue presented is whether section 208 (subd. 9, par. [i], subpar. [B]) of the Tax Law is unconstitutional insofar as it purports to tax the accumulated income of a domestic international sales corporation (DISC), an entity which is the beneficiary of certain tax advantages under the Internal Revenue Code. A related issue concerns the obligation of a corporation doing business in New York, which is a shareholder of a DISC, when calculating its own income for state franchise tax purposes, to include income deemed to have been distributed to it by the DISC. The facts have been stipulated.

Petitioner, Westinghouse Electric Corporation (Westinghouse), a Pennsylvania corporation, does business in New York. It owns all of the stock of Westinghouse Electric Export Corporation (Westinghouse DISC), a Delaware corporation,

which acted as a commission agent for Westinghouse and affiliated companies, and which in 1972 and 1973 had qualified for DISC status under the Internal Revenue Code (U.S. Code tit. 26 § 991 *et seq.*). Westinghouse DISC's business income consisted entirely of commissions derived from export sales of products and related services made on behalf of Westinghouse and affiliated companies. Throughout this period it did not engage in any business activities in New York.

Under the provisions of the Internal Revenue Code, Westinghouse DISC itself was exempt from Federal income tax liability. However, a portion of its earnings and profits was "deemed distributed" to its shareholder (Westinghouse), whether or not it was actually distributed, and was directly taxable to the latter as a dividend (U.S. Code, tit. 26, § 995, subd. [b]). Federal taxation of the remainder of Westinghouse DISC's income, characterized as "accumulated income", was deferred. When Westinghouse filed its New York corporation franchise tax returns for these years, it included the deemed distributions from Westinghouse DISC in its net income, but not any portion of the DISC's accumulated income.

The State Department of Taxation and Finance charged that deficiencies existed in the amount of franchise tax due from Westinghouse. Specifically, the department, relying on section 208 (subd. 9, par. [i], subpar. [B]) of the Tax Law, maintained that in arriving at its franchise tax Westinghouse should have combined all of Westinghouse DISC's income and expenses with its own, other than transactions between the two companies. Except for correcting an arithmetic error, respondents rejected Westinghouse's petition challenging the deficiencies and this proceeding followed.

We determine that section 208 (subd. 9, par. [i], subpar. [B]) of the Tax Law, to the extent it requires Westinghouse DISC's accumulated income be added to petitioner's income, is unconstitutional, for it settles an impermissible burden on foreign commerce (U.S. Const., art. 1, § 8, cl. [3]).

Enacted in 1971, sections 991 through 997 of the Internal Revenue Code created DISCs, a new class of corporation.

These corporations, receiving special tax treatment, derive substantially all of their income from export sales of properties manufactured in the United States, including commissions attributable to such sales. The essential purpose behind enactment of the DISC provisions was to encourage exportation to foreign countries of American made products so as to alleviate a burgeoning deficit in the United States balance of payments (*Caterpillar Tractor Co. v. United States*, 589 F.2d 1040). A correlative concern, expressed by the Senate Finance Committee, was to remove a competitive disadvantage experienced by domestic corporations engaged in export activities (S. Rep. No. 92-437, 92nd Cong., 1st Sess. 90 [1971] reprinted in [1971] U.S. Code Cong. & Admin. News, pp. 1918, 1996). The DISC provisions of the Code being unmistakably aimed at improving foreign commerce, any state impediment hindering that congressional intent is not constitutionally allowable.

In the calculation of the New York State franchise tax, section 208 (subd. 9, par. [i], subpar. [B]) of the Tax Law directs that a DISC's shareholder's attributable share of each receipt and expense of the DISC be added to the shareholder's income. Since that requires Westinghouse DISC's accumulated income be added to Westinghouse's entire net income, to be taxed thereon, it in effect imposes a tax on Westinghouse DISC's accumulated income, contrary to the congressionally established policy that such income currently be treated as tax exempt. By so computing petitioner's franchise tax, respondents encumber Congress's purpose in creating DISCs, for they diminish the tax advantage Congress bestowed on United States corporations engaged in foreign export trade. Although the Code's DISC provisions do not explicitly prohibit states from directly or indirectly taxing accumulated income, given their purpose it would be incongruous to suggest such a prohibition was not intended. As the State's statute infringes on Congress's power to regulate commerce, it necessarily must fall (*see Boston Stock Exchange v. State Tax Comm.*, 429 U.S. 318; *McGoldrick v. Gulf Oil Corp.*, 309 U.S. 414).

Petitioner also maintains that the inclusion of Westinghouse DISC's deemed distributions in Westinghouse's in-

come is invalid on equal protection and due process grounds. Neither claim is convincing.

With regard to its equal protection argument, Westinghouse urges that since dividends from subsidiaries, in general, are not subject to New York franchise tax, respondents have discriminated against it by requiring petitioner to include in its net income deemed distributions from Westinghouse DISC. There is nothing in the record to indicate that petitioner's tax liability resulting from a combined report, which in view of the extensive intercompany transactions could have been required here if Westinghouse DISC had been considered merely as a subsidiary (Tax Law, § 211, subd. 4; *Matter of Wurlitzer Co. v. State Tax Comm.*, 35 N.Y.2d 100), would be less than that which was in fact imposed.

As for the due process argument, Westinghouse maintains Westinghouse DISC neither engaged in business in New York nor participated in any other activities sufficient to justify a jurisdictional nexus and that, therefore, inclusion of the DISC's deemed distributions was improper. But where, as here, the activities of the parent and subsidiary are so interrelated as to constitute a single unitary business, separate geographical accounting is not required for purposes of state taxation and a reasonable apportionment formula fairly representing the amount of business apportioned to the state may be utilized (*Mobil Oil Corp. v. Comr. of Taxes*, 445 U.S. 425).

Determination annulled, with costs, and matter remitted to the State Tax Commission for further proceedings not inconsistent herewith.

MAIN, MIKOLL and YESAWICH, JR., JJ., concur; MAHONEY, P. J., and HERLIHY, J., dissent and vote to confirm in the following memorandum by HERLIHY, J.

HERLIHY, J. (dissenting):

We join in the majority opinion as to the conclusion that the tax at issue herein does not violate the requirements of due process or equal protection.

However, while petitioner's view of the Federal treatment of income derived from domestic corporations engaged in export activities as regulating foreign commerce has some merit, the fact remains that the Internal Revenue Code does not exempt the income from taxation. The tax imposed herein is based upon the taxpayer's relationship to the wholly-owned subsidiary and is unrelated to the subsidiary's function of overseas sales—foreign commerce.

Petitioner has failed to demonstrate any tax imposed on foreign commerce or any implicit prohibition on the power of the State to allocate net income to the shareholder as a portion of income subject to the New York State franchise tax. Upon the present record, the inference that the Internal Revenue Code is an exclusive regulation of foreign commerce is speculative and does not suffice to overcome the presumption of the constitutionality of the New York statute.

The determination of the Tax Commission should be confirmed, and the petition dismissed.

ORDER OF THE APPELLATE DIVISION

At a Term of the Appellate Division of the Supreme Court of the State of New York, held in and for the Third Judicial Department in the City of Albany, New York, commencing on the 20th day of April 1981.

PRESENT:

Hon. A. FRANKLIN MAHONEY,
Presiding Justice,

Hon. ROBERT G. MAIN,
Hon. ANN T. MIKOLL,
Hon. PAUL J. YESAWICH, JR.,
Hon. J. CLARENCE HERLIHY,
Associate Justices.

In the Matter of the Application of
WESTINGHOUSE ELECTRIC CORPORATION,
Petitioner,

For a Judgment Pursuant to Article 78 of the Civil Practice Law and Rules

v.

JAMES H. TULLY JR., MILTON KOERNER and THOMAS H. LYNCH, as the Tax Commission of the State of New York,
Respondents.

Albany County Clerk's Index No. 11313/79

Order of Annullment

The above-named petitioner, having instituted this proceeding in the Supreme Court, Albany County, pursuant to Article 78 of the Civil Practice Law and Rules, to review a determination of respondents, dated August 31, 1979, which sustained the imposition of corporate franchise tax assessments

imposed pursuant to Article 9-A of the Tax Law and said proceeding having been transferred for disposition to the Appellate Division, Third Department, by order of the Supreme Court, Albany County, dated and entered on January 25, 1980, and having been presented during the above-stated Term of this Court, and having been argued by Cravath, Swaine & Moore (Henry W. de Kosmian, of counsel), for petitioner, and by Robert Abrams, Attorney General of the State of New York (Francis V. Dow, Assistant Attorney General, of counsel), for respondents, and after due deliberation the Court having rendered a decision on the 18th day of June, 1981, Mahoney, Presiding Justice and Herlihy, Justice, dissenting, it is hereby

ORDERED, that the determination be and the same hereby is annulled, with costs, and the matter is remitted to the respondent Tax Commission of the State of New York for further proceedings not inconsistent with the June 18, 1981, decision of this Court.

ENTER:

JOHN J. O'BRIEN
Clerk

DATED AND ENTERED: June 29, 1981.

A TRUE COPY
/s/ JOHN J. O'BRIEN
Clerk

DECISION OF THE COURT OF APPEALS

COURT OF APPEALS
STATE OF NEW YORK

No. 97

In the Matter of WESTINGHOUSE ELECTRIC CORPORATION,

Respondent-Appellant,

v.

JAMES H. TULLY, JR., et al., constituting the Tax Commission of the State of New York,

Appellants-Respondents.

Argued February 9, 1982; decided April 1, 1982

Robert Abrams, Attorney-General (Francis V. Dow and Shirley Adelson Siegel of counsel) for appellant.

Henry W. deKosmian and Simon Friedman, for respondent.

OPINION OF THE COURT

FUCHSBERG, J.:

In an article 78 proceeding to review a determination of the State Tax Commission which sustained corporate franchise taxes imposed pursuant to Article 9-A of the Tax Law, we are called upon to pass on the constitutionality of New York statutes which tax income emanating from the earnings of a "domestic international sales corporation" (hereinafter referred to by the acronym "DISC"), a class of corporations newly made eligible for preferential tax treatment by the Federal Revenue Act of 1971.

The primary requirement for qualification as a DISC is that a corporation must derive at least 95 per cent of its income from export sales and related services. The tax advantages it receives are intended to encourage the export of goods manufactured in the United States by compensating for the far lower taxes many foreign subsidiaries of American companies pay to the nations in which they operate (*see* H. Rep. No. 92-533, 92d Cong., 1st Sess., [1971], reprinted in US Code Cong. & Admin. News 1825, 1872; S. Rep. No. 92-437, 92d Cong., 1st Sess., [1971], reprinted in US Code Cong. & Admin. News 1918, 1928, 1996). To effect the contemplated tax benefit, the implementing statute, besides exempting a DISC from Federal taxation, permits half of its income to be "accumulated" without subjecting its shareholders to current Federal taxes. On the other hand, the other half is "deemed distributed" to the shareholders even if it in fact is not paid out as a dividend (*see* US Code, tit 26, § 991 *et seq.*).[1]

The DISC involved in the present proceeding, a Delaware corporation named Westinghouse Electric Export Corporation, is a wholly-owned subsidiary of Westinghouse Electric Corporation (Westinghouse), a Pennsylvania corporation which does business in New York. It is undisputed that all of the DISC's business income for 1972 and 1973, the years under review here, was earned as commission agent for either Westinghouse or the latter's affiliates.[2] Moreover, it is agreed that none of the usual incidents of a nexus with New York applied to the DISC, it having operated no office, engaged no employees, conducted no business activities, employed no capital and neither owned nor leased real or tangible personal property. Concordantly, it did not file New York franchise tax returns.

It was against this background that, when Westinghouse filed its 1972 and 1973 New York franchise tax returns, though it

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[1] Since no questions are raised as to the tax ramifications of an actual distribution of DISC income or the eventual taxability of the accumulated DISC income, we do not treat with such issues in this opinion.

[2] None of the affiliates did business in New York.

included its "deemed distributions" from the DISC in its "entire net income" (*see* Tax Law, § 208.9[a][1]), it did not charge itself with any portion of the "accumulated" DISC income. Finding these returns deficient, New York State's Department of Taxation and Finance took the position that Westinghouse, in its treatment of the DISC income, had failed to comply with Tax Law, § 208.9(i)(B), which, in essence, requires a reporting corporation to compute its "entire net income" by consolidating its DISC's receipts, expenses, assets and liabilities with its own, save for transactions between it and its DISC. Such consolidation, of course, would have added the accumulated DISC income which had been deferred for Federal tax purposes.[3] Against the deficiency assessed on this basis, the Department did allow Westinghouse a DISC export credit for merchandise "shipped from a regular place of business of the taxpayer within this state", all pursuant to a formula set out in section 210.13(a) of the Tax Law (*see infra* p. 7).

In its petition for a redetermination, Westinghouse alleged that inclusion of accumulated DISC income in its "entire net income" would impose an undue burden on interstate and foreign commerce (US Const, art I, § 8, cl 3);[4] that, in violation

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[3] Tax Law § 208.9(i)(B), in pertinent part, reads: "[A]ny taxpayer required to compute a tax under this article, which during the taxable year being reported was a stockholder in any DISC . . . shall . . . adjust each item of its receipts, expenses, assets and liabilities, as otherwise computed under this article, by adding thereto its attributable share of each such DISC's receipts, expenses, assets and liabilities . . . provided, however, (1) that all transactions between the taxpayer and each such DISC shall be eliminated from the taxpayer's adjusted receipts, expenses, assets and liabilities; (2) that the taxpayer's entire net income as otherwise computed under this section, shall be reduced by subtracting the amount of the deemed distribution of current income, if any, from each such DISC already included in the entire net income of such taxpayer by virtue of having been included in its entire taxable income for that taxable year as reported to the United States Treasury Department".

[4] The commerce clause provides that "The Congress shall have Power . . . to regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes."

of the due process clauses of the State and Federal Constitutions, New York lacked a jurisdictional nexus upon which to tax the DISC's income; and that, if the DISC's accumulated income had to be included in "entire net income", Tax Law, § 210.13(a), which provides the tax credit, offends the commerce clause because it discriminates against shipments of export property from locations outside the State. In addition, Westinghouse, asserting that State taxation of the deemed distributions of DISC trespassed on due process and equal protection, demanded that the taxes it had paid on such be refunded.[5] The State Tax Commission rejected all of these contentions.

For its part in this proceeding, the Appellate Division, two justices dissenting, found that section 208.9(i)(B), in requiring the DISC's accumulated income to be added to the taxpayer's "entire net income", constituted an unconstitutional imposition on foreign commerce. Having found that 208.9(i)(B) violated the commerce clause, the court did not address Westinghouse's claim that the provision was also invalid for lack of due process. Nor did the court decide the constitutionality of the tax credit of 210.13(a), apparently because this section expressly is made dependent on the validity of 208.9(i)(B). Finally, it rejected Westinghouse's due process and equal protection contentions regarding the inclusion of the deemed distribution income. For the reasons which follow, we believe none of the constitutional objections has merit.

Turning at once to Westinghouse's primary argument —that the addition of the accumulated DISC income to Westinghouse's "entire net income" as called for by Tax Law § 208.9(i)(B) frustrates the efficacy of the Federal tax incentive and, therefore, runs counter to the fundamental policy dictates of the commerce clause—we first pay heed to the well-settled proposition that the ultimate power to regulate both

[5] Westinghouse also contended that the State Tax Commission had transposed certain numbers creating an arithmetical miscalculation of the tax. In its answer, the Commission conceded this error.

foreign and interstate commerce lies with Congress (*see, e.g., Gibbons v. Ogden*, 9 Wheat [22 US] 1,86-87). However, that a State chooses to act in the same field as does Congress does not automatically portend judicial nullification of the State law (*see Walhalla Associates, Inc. v. National Commercial Bank and Trust Co.*, 54 N.Y.2d 857; *see, generally*, Tribe, American Constitutional Law, § 6-24, p. 379). It all hinges on whether Congress intended to preempt State regulation (*see Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 229-230).

This said, we note that in the present case there is no explicit statement of preemption. Nor does the statutory scheme imply any such design. True, it bespeaks a plan to give special tax treatment to DISCs and their stockholders in order to encourage export sales of goods manufactured in the United States. But that some benefits were extended to accomplish this end does not mean that every possible kind was intended. To the contrary, even as to Federal taxation, the incentives tendered a DISC's shareholders, the ultimate beneficiaries of a DISC's tax preferment, are far more limited than those offered to the DISC per se.[6]

Most persuasive is the relevant legislative history. This leaves little to implication. On September 8, 1971, shortly before the DISC legislation was enacted, John S. Nolan, Deputy Assistant Secretary of the Treasury for Tax Policy, spokesman for the sponsoring department, in the company of then Secretary of Treasury John B. Connally, officially appeared at a hearing before the Committee on Ways and Means of the House of Representatives. There, Mr. Nolan, in response to an expression of committee concern that the proposal might "prohibit States from levying corporate income taxes on a DISC" was unequivocal in his declaration that the proposed bill would leave the States "free to impose the tax, if they choose to do so" (*see* Hearings before House Committee on Ways and

[6] We also observe that even accumulated DISC income is taxable to the shareholders when it is distributed, when a shareholder sells his stock or when the corporation no longer qualifies as a DISC (*see* US Code, tit 26, § 995).

Means on the Tax Proposals Contained in the President's New Economic Policy, 92nd Cong., lst Sess., Part I, pp. 170-171). Moreover, not without significance, proposed legislation which might have preempted the States from taxing DISCs was considered by the same committee in 1980, only to be permitted to die without any action (*see* HR 5076, 96th Cong., 2nd Sess.; Hearing before Committee on Ways and Means on State Taxation of Foreign Source Income, p. 29, 326). Overall, then, our State is far from constrained by a clear statement that Congress intended to exercise its commerce power in full (*see* Tribe, American Constitutional Law, § 5-8, p. 243).

On this point, comments also are in order on *McGoldrick v. Gulf Oil Corp.* (309 U.S. 414) to which Westinghouse adverts to support its position. There, a Federal statute permitted the importation of crude petroleum into the United States free of import duty. However, the statute specified that the petroleum be imported, converted into fuel oil and then sold solely for fuel in propelling foreign-bound vessels in foreign commerce, all while in bond. These *congressionally-designed* conditions prevented the segregated oil from ever becoming a part of "the common mass of property in the state" (*McGoldrick, supra,* at p. 423). The Supreme Court emphasized that it was this integrated structure for assuring that the oil never left the stream of foreign commerce, which has no parallel in this case, that compelled the conclusion that "while in bonded warehouse, [the oil is] free from state taxation" (*McGoldrick, supra,* at pp. 428-429).

The second prong of Westinghouse's constitutional attack on section 208.9(i)(B) is that, since neither the DISC nor any of Westinghouse's affiliates for which it acted as export commission agent were engaged in business in New York, the State lacked the jurisdictional nexus to satisfy the minimal due process standards on which the right to tax must be predicated. We find this assertion equally without merit. Revealing in this connection is the recent decision in *Mobil Oil Corporation v. Commissioner of Taxes* (445 U.S. 425). In the context of a challenge to Vermont's taxation of dividend income received by

a taxpayer from foreign subsidiaries and affiliates, the court reminded us that in such a case, due process mandates can be met by a State's apportionment formula so long as it is reasonably designed to reflect the percentage of a unitary business' profits connected with the State (*see Mobil Oil, supra,* at pp. 436-440; *cf. American Ins. Assn. v. Lewis,* 50 N.Y.2d 617, 623-624).

Here the record shows that Westinghouse and its DISC were operating a unitary business. Not all the accumulated DISC income was subjected to taxation, but rather only that part allocable to New York (Tax Law, §§ 208.9[i][B], 210.1[a], 210.3; *cf. Fischbach & Moore v. Tax Comm.,* 36 N.Y.2d 605, 607). Moreover, there is nothing in the record to show that the income was improperly apportioned to business done in New York; nor does the taxpayer question our State's allocation formula.[7]

This brings us to the Westinghouse argument that, even if the inclusion of the accumulated DISC income required by section 208.9(i)(B), standing alone, does not contravene the commerce clause, an infringement occurs when it is acted upon by the tax credit provided for in section 210.13(a). It reasons that the effect of the credit is impermissibly to subject its export sales from a non-New York "place of business" to a higher rate of tax than comparable sales "shipped from a regular place of business" within New York.

The credit was devised, by the State on its own, to provide shareholders of DISCs with State tax incentives akin to those which had been enacted by the Federal government (*see* Letter from Norman F. Gallman, Commissioner of Taxation and Finance to Governor Nelson A. Rockefeller in bill jacket [at p.

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[7] Tax Law § 210.3 provides for an allocation of a taxpayer's total business income from all sources by the application of a three-factor formula, the three factors being the fractions represented by a taxpayer's property within New York over all its property, a taxpayer's payroll within New York over its total payroll and a taxpayer's receipts from within New York over its total receipts.

3-4] of L 1972, ch 778; Memorandum of Department of Commerce in bill jacket [at p. 12] of L 1972, ch 778; Division of the Budget Report in bill jacket [at p. 19] of L 1972, ch 778). Such credit was intended to ensure that New York would not lose its competitive position vis-a-vis other States which were also expected to offer tax benefits to DISC owners (*see* Letter from Arthur M. Arnold, Director of Taxation and Governmental Affairs of the Empire State Chamber of Commerce in bill jacket [at p. 28] of L 1972, ch 778; Memorandum in Support by New York Chamber of Commerce in bill jacket [at p. 29] of L 1972, ch 778). While Congress chose to provide the benefit in the form of a tax deferral, our State Legislature elected to use a tax credit.

That a State's tax structure is so used hardly requires an *ipso facto* finding that we have discriminated against multi-state enterprises in favor of intrastate corporations. Rather, States are free to use their taxing power "to encourage the growth and development of intrastate commerce and industry . . . [and to] compete with other States for a share of interstate commerce; such competition lies at the heart of a free trade policy" (*Boston Stock Exchange v. State Tax Commn.*, 429 U.S. 318, 336-337). That this is what the credit allowed by § 210.13(a) accomplishes, and no more, is demonstrated by a review of how it is calculated.

The first step to be taken to arrive at the amount of such tax credit is to multiply the taxpayer's share of the accumulated DISC income by the taxpayer's New York "business allocation percentage" (Tax Law, § 210.3). This yields the dollar value of the accumulated DISC income allocable to New York as *in-state* earnings. This amount is then multiplied by that percentage which the taxpayer's receipts from export property on which the DISC earned commissions *and* which was shipped from a regular place of business in New York bears to the taxpayer's total receipts from the sale of export property on which the DISC earned commissions. The product of this calculation is the amount eligible for the credit; it is merely a

subdivision of the accumulated DISC income allocable to New York.[8]

Obviously, the business allocation percentage plays an integral role in computing the tax credit. It determines what amount of the taxpayer's income has a jurisdictional nexus with the State. The result is that, when the State exercises its taxing power, it does so consistently with due process mandates (*Northwestern Cement Co. v. Minnesota*, 358 U.S. 450; *Wisconsin v. Penney Co.*, 311 U.S. 435).

But New York need not tax all which it has the right to tax. The credit here simply forgives a portion of that income which New York may tax by reference to shipments of export property from a regular place of business in New York, an additional New York relationship. Such a method clearly satisfies due process, and any effect on interstate commerce is too indirect to run afoul of the commerce clause.

Now, having disposed of the arguments on which Westinghouse seeks to overturn the Tax Commission's assessment, we treat with its claim for reimbursement of its allegedly mistaken payment of tax on the deemed distributions. Its position, again cast in constitutional terms, is that taxation of such income infringes upon both due process and equal protection.

Its alleged due process position is no different from the one it took regarding taxation of accumulated DISC income, *i.e.*, New York lacks a sufficient nexus with the DISC to tax its income. But, since Westinghouse and the DISC are parts of a unitary business and there is an apportionment of the income

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[8] The dollar value of the credit is then determined by multiplying the amount available for the credit by 70% and then by the tax rate (Tax Law, § 210.13[a]). According to a memorandum prepared by the State Department of Commerce before the DISC legislation was enacted, "[t]he 70 percent factor included in the export credit formula [was] apparently designed to minimize revenue loss while still providing some tax incentive for the export business" (Memorandum of Department of Commerce in bill jacket [at p. 12] of L 1972, ch 778).

allocable to New York, there is no due process violation (*Mobil Oil Corporation v. Tax Commissioner*, 445 U.S. 425, *supra*).

As for equal protection, Westinghouse would have us hold that, since New York law provides that the income from all non-DISC subsidiaries is exempt from the State's franchise tax (Tax Law, § 208.9[a][1]), it is irrational to tax it on the deemed distribution income of its wholly-owned DISC subsidiary (Tax Law, § 208.8-A[b]). But, if the DISC had not elected to be treated as a domestic international sales corporation, the intercompany transactions in which it engaged would have compelled the Commission to require it and Westinghouse to file a combined report (see Tax Law, § 211 [4]). In the event, the allocated income of the DISC would be combined with the allocated income of Westinghouse (*see Matter of Wurlitzer Co. v. State Tax Commn.*, 35 N.Y.2d 100). As the Appellate Division correctly observed, "[t]here is nothing in the record to indicate that petitioner's tax liability resulting from a combined report . . . would be less than that which was in fact imposed" (82 A.D.2d 988, 989).

For all these reasons, the judgment of the Appellate Division should be modified by reinstating the determination of the State Tax Commission.

Chief Judge COOKE and Judges JASEN, GABRIELLI, JONES, WACHTLER and MEYER concur.

Judgment modified, with costs to the State Tax Commission, in accordance with the opinion herein and, as so modified, affirmed.

ORDER OF THE COURT OF APPEALS

COURT OF APPEALS
STATE OF NEW YORK

The Hon. Lawrence H. Cooke, Chief Judge, Presiding

No. 97

In the Matter of WESTINGHOUSE ELECTRIC CORPORATION,

Respondent-Appellant,

v.

JAMES H. TULLY, JR., & ors., as the Tax Commission of the State of New York,

Appellants-Respondents.

The appellant(s)-respondents in the above entitled appeal appeared by Robert Abrams, Attorney General;

The respondent(s)-appellant appeared by Cravath, Swaine & Moore.

The Court, after due deliberation, orders and adjudges that the judgment is modified, with costs to the State Tax Commission, in accordance with the opinion herein and, as so modified, affirmed. Opinion by Judge Fuchsberg. Chief Judge Cooke and Judges Jasen, Gabrielli, Jones, Wachtler and Meyer concur.

The Court further orders that the papers required to be filed and this record of the proceedings in this Court be remitted to the Supreme Court, Albany County, there to be proceeded upon according to law.

I certify that the preceding contains a correct record of the proceedings in this appeal in the Court of Appeals and that the papers required to be filed are attached.

/s/ JOSEPH W. BELLACOSA

Joseph W. Bellacosa,
Clerk of the Court

Court of Appeals, Clerk's Office, Albany, April 1, 1982.

Office - Supreme Court, U.S.
FILED
JUL 29 1982
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No. 81-2394

IN THE

Supreme Court of the United States

October Term, 1981

WESTINGHOUSE ELECTRIC CORPORATION,
Appellant,

against

JAMES H. TULLY, JR., *et al.*, As The Tax Commission of the State of New York,
Appellees.

ON APPEAL FROM THE COURT OF APPEALS OF THE STATE OF NEW YORK

MOTION TO DISMISS OR AFFIRM

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Questions Presented.

1. Whether the provisions of the New York State Tax Law which limits eligibility for an export tax credit against taxes measured by the New York income of a domestic international sales corporation (DISC) from the sale of export property shipped from a regular place of business in New York State, violate the Commerce Clause of the United States Constitution and the Equal Protection Clause of the Fourteenth Amendment to the United States Constitution?

2. Does the New York Tax Law which imposes a tax on the consolidated income of a corporation and its wholly owned DISC subsidiary allocable to New York, violate the Commerce Clause of the United States Constitution and the Due Process Clause and Equal Protection Clauses of the Fourteenth Amendment to the United States Constitution, where no showing has been made that the tax is being imposed on income of affiliates of a parent which are not doing business in New York State?*

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*Westinghouse Electric Corporation was the respondent-appellant in the New York Court of Appeals. James H. Tully, Jr., Milton Koerner and Thomas H. Lynch, as the Tax Commission of the State of New York, were the appellants-respondents.

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No. 81-2394

IN THE

SUPREME COURT OF THE UNITED STATES,

OCTOBER TERM, 1981.

WESTINGHOUSE ELECTRIC CORPORATION,

Appellant,

against

JAMES H. TULLY, Jr., *et al.*, As The Tax Commission of The State of New York,

Appellees.

ON APPEAL FROM THE COURT OF APPEALS OF THE STATE OF NEW YORK.

Motion to Dismiss or Affirm.

The appellees move the Court to dismiss the appeal on the ground that it is manifestly evident that this case presents no substantial Federal question. This appeal is from an order of the Court of Appeals of the State of New York, entered on April 1, 1982, which unanimously modified, and as so modified, affirmed an order of the Appellate Division, Third Department, of the Supreme

Court of the State of New York, in accordance with the opinion (Judge Fuchsberg) of the New York State Court of Appeals.

The opinion of the New York Court of Appeals, dated April 1, 1982, is reported at 55 N.Y. 2d 364 and 449 N.Y.S. 2d 677, and is reprinted in the appellant's Appendix ("App.") to its Jurisdiction Statement at pages 1a-10a. The unpublished Order of the New York Appellate Division, Third Judicial Department, dated June 29, 1981, appears at App. 11a-12a. The decision of the Appellate Division, Third Judicial Department, dated June 18, 1981, is reported at 82 A.D. 2d 988 and 440 N.Y.S. 2d 397, and is reprinted at App. 13a-17a. The unpublished order of the Supreme Court of the State of New York transferring the proceedings to the Appellate Division, dated January 25, 1980, appears at App. 18a-19a. The unpublished decision of the New York State Tax Commission, dated August 31, 1979, appears at App. 20a-26a.

Relief Requested.

This Court should dismiss the appeal on the ground that it does not present a substantial Federal question. Alternatively, this Court should affirm for the reasons expressed by the New York State Court of Appeals below.

Statutory Operation.

Under the Internal Revenue Code (Public Law 92-178) for taxable years beginning after 1971, a domestic sales corporation whose income is predominantly (95%) derived from export sales and rentals may defer paying United States tax up to 50% of that income. The other

half is taxed directly to shareholders even though it is not distributed to the shareholders, but under the law is "deemed" distributed to them. Such distributions are deemed part of such shareholders' Federal taxable income. A corporation entitled to this treatment is referred to as a "Domestic International Sales Corporation" (DISC). The tax-deferred income is never taxed to the DISC. Such income is taxed to the shareholders only when distributed, when a shareholder sells his stock, or when the corporation no longer qualified as a DISC. The 50% of the DISC's income that is taxed directly to shareholders, certain other constructive distributions, and actual distributions to shareholders are treated as dividends (but, in the case of actual distributions, only to the extent that they exceed income previously taxed directly to shareholders). The shareholders are entitled to claim an Internal Revenue Code, § 902, "deemed" foreign tax credit for taxes paid by a DISC to foreign countries. A DISC may not join in filing a Federal consolidated return. Under the intercompany pricing rules of the Federal law, a DISC may earn profits although in excess of profit it would earn in an arm's length transaction and regardless of the sales price actually charged on products which it purchases from a related company and then resells for export.

Public Law 92-178 enacted December 10, 1971 was designed to provide Federal "tax incentives for United States firms to increase their exports". H.R. No. 92-533, 92nd Congress, 1st Sess. (1971), U.S. Code Cong. & Admin. News, p 1825 at 1872; Senate Report 92-437, *id.*, p 1918 at 1928. It was not designed to regulate commerce. "As a general rule, the bill provides that a DISC is not to be subject to income taxes (or more specifically the taxes imposed by subtitle A) [Income Taxes imposed by Internal Revenue Code] although the shareholders are taxed on an

amount representing up to 75 percent of a DISC's base period income." *U.S. Code Cong. & Admin. News*, Vol 2, at p 1873 (1971).

On September 8, 1971, shortly before the DISC legislation was enacted, John S. Nolan, Deputy Assistant Secretary of the Treasury for Tax Policy, spokesman for the sponsoring department, in the company of then Secretary of Treasury John B. Connally, officially appeared at a hearing before the Committee on Ways and Means of the House of Representatives. There, Mr. Nolan, in response to an expression of committee concern that the proposal might "prohibit States from levying corporate income taxes on a DISC" was unequivocal in his declaration that the proposed bill would leave the States "free to impose the tax, if they choose to do so" (*see* Hearings before House Committee on Ways and Means on the Tax Proposals Contained in the President's New Economic Policy, 92nd Cong., 1st Sess., Part I, pp. 170-171). Proposed legislation which might have preempted the States from taxing DISCs was considered by the same committee in 1980, only to be permitted to die without any action (*see* HR 5076, 96th Cong., 2nd Sess.; Hearing before Committee on Ways and Means on State Taxation of Foreign Source Income, p. 29, 326).

A DISC is not taxed by New York State. When a corporate taxpayer subject to franchise tax for the exercise of the privilege of doing business in New York State under Article 9-A of the Tax Law is a shareholder of an exempt DISC, the corporate taxpayer must file its own tax report and a consolidated report with the DISC. The consolidated report must contain the attributable share (based on percentage of stock ownership) of the receipts, expenses, assets and liabilities of the DISC as well as the property,

receipts and wages of the DISC eligible for use in the computation of the business allocation percentage. The corporate taxpayer must adjust its receipts, expenses, assets and liabilities to include its attributable share of the DISC's receipts, expenses, assets and liabilities; eliminate any deemed or actual distributions received from the DISC to the extent already included in entire net income; and eliminate intercorporate transactions between the corporate taxpayer and the tax exempt DISC (McKinney's New York Tax Law, §§ 208[9] [i], 210 [3] [a]). As an alternate to filing a consolidated return with a DISC, a corporate taxpayer may elect to file a tax report on a combined basis with a DISC because of intercompany transactions in order to properly reflect its tax liability (McKinney's New York Tax Law, § 211[4]).

Further, New York State allows a stockholder of exempt DISCs a DISC export credit, computed separately for each DISC, after allowance of any credit for an eligible business facility and the credit for investment in production facilities. The credit is computed as follows:

(1) Stockholder's share of DISC earnings and profits X (Gross receipts from export property shipped from a regular place of business within the State / Gross receipts from the sale, rental or other disposition of export property) X Taxpayer's business allocation percentage = Taxable income eligible for the credit

(2) Taxable income eligible for credit X 70% X Taxpayer's rate of tax = Credit attributable to each DISC

(McKinney's New York Tax Law, § 210 [13] [a])

Under the New York Tax Law income, gains and losses from subsidiary capital are excluded in computing entire net income. In place of a tax on subsidiary income, a separate tax measured by subsidiary capital* is imposed as part of the New York corporation franchise tax unless a combined report is filed by the subsidiary with its parent. The separate tax on subsidiary capital is in addition to the tax measured by entire net income, other alternative basis or the flat minimum tax.

A "subsidiary" not a DISC is defined to mean a corporation which is controlled by the taxpayer by reason of its actual beneficial ownership of 50% of the issued and outstanding stock entitled to vote for the election of directors or trustees of the corporation. No tax is imposed on subsidiary capital where the subsidiary does not do business in New York.

Factual Statement.

Westinghouse Electric Corporation (Westinghouse) is engaged in the manufacture, sale and installation of electrical and steam apparatus and does business in New York. Westinghouse owns all of the stock of Westinghouse Electric Export Corporation (Westinghouse DISC), a Delaware corporation which elected to be treated as a "domestic international sales corporation" for Federal income tax purposes and was so treated for the years involved.

*Subsidiary capital includes (1) investments in stocks of subsidiaries, and (2) the amount of indebtedness owed to a taxpayer by its subsidiaries, exclusive of accounts receivable acquired in the ordinary course of trade or business for services rendered or for sales of property held primarily for sale to customers, on which no interest was claimed and deducted for the purpose of any New York franchise tax imposed by Articles 9-A, 9-B, 9-C, 32 or 33 of the New York Tax Law.

Westinghouse DISC had no paid employees, did not engage in business activities in New York State, did not employ capital, own or lease real or tangible personal property, pay real estate rentals, or maintain an office in New York State at any time during the years involved. It did not file New York corporate franchise tax returns.

Westinghouse DISC received all of its business income for the years involved acting as a commission agent for Westinghouse and affiliated companies in respect to export sales of property and related services. Westinghouse DISC reported total income on Federal Form 1120-DISC as follows:

Sources of Income	*1972*	*1973*
From Westinghouse	$19,888,000	$47,180,132
From affiliated companies of Westinghouse	6,099,000	10,768,606
TOTALS	$25,987,000	$57,948,738

The affiliated companies did not do business in New York State.

Under the provisions of section 995(b) of the Internal Revenue Code, $12,956,500 for 1972 and $29,838,006 for 1973 was deemed distributed to Westinghouse during those years. Westinghouse accordingly included those amounts in its Federal gross income for those years. Federal taxation of the remainder of Westinghouse DISC's income for those years was deferred under the provisions of the Internal Revenue Code.

Westinghouse DISC made no distribution of income in 1972, but in 1973 it distributed $10,068,500 to Westinghouse. For Federal purposes this distribution was treated

as made out of previously taxed income under section 996(a) (1) of the Internal Revenue Code.

Westinghouse filed New York State corporation franchise tax returns for these years in which it reported entire net income of $136,516,711 for 1972 and $43,715,850 for 1973. These amounts included the $12,956,500 and $29,838,006 deemed distribution of income from Westinghouse DISC for those respective years. The reported income did not include any portion of Westinghouse DISC's accumulated income which was deferred for tax purposes under Federal law.

On the New York State returns, Westinghouse's reported entire net income was allocated to New York State under "business allocation percentages of 6.387743% for 1972 and 6.239516% for 1973 computed without regard to such deemed distributions" by Westinghouse DISC. Westinghouse paid New York State franchise taxes in the amount of $749,384 for 1972 and $205,548 for 1973.

After an audit of Westinghouse, notices of deficiency were issued for the years in the amount of $73,970.23 plus interest for 1972 and $151,436.76 plus interest for 1973. An error was made in the calculation of the deficiency for 1972 because of a transposition of a number. The deficiency of tax, if the error had not been made, should be $71,970 for that year.

The notices of deficiency of tax were computed by the New York State Tax Commission on the following basis:

(a) Because more than 5% of Westinghouse DISC's gross receipts in both 1972 and 1973 consisted of sales

commissions from Westinghouse, Westinghouse DISC is exempt from New York State franchise tax under § 208.9(i) (A) of the New York Tax Law, whether or not New York State otherwise had jurisdiction to subject it to tax. Westinghouse is required under section 208.9(i) (B) of the New York Tax Law to consolidate Westinghouse DISC's receipts, expenses, assets and liabilities with its own in computing its New York State income tax liability, excluding all transactions between Westinghouse and Westinghouse DISC. Since Westinghouse included only the deemed distributions from Westinghouse DISC for 1972 and 1973, and not all Westinghouse DISC's income for such years in its own entire net income for 1972 and 1973, Westinghouse's entire net income for 1972 was increased by $13,390,500 (correct amount should be $13,030,500) from $136,516,711 to $149,907,211 and its entire net income for 1973 was increased by $28,110,732 from $43,715,850 to $71,826,582;

(b) The receipts factors used to compute Westinghouse's business allocation percentages for 1972 and 1973 were recomputed by adding Westinghouse DISC's commission income derived for such years from customers other than Westinghouse (which other customers did not do business in New York State and were not subject to New York tax) to the denominator of such factors, but not to the numerator, thus reducing Westinghouse's receipts factor for 1972 from 5.945712% as reported on its 1972 return to 5.935845% and reducing its receipts factor for 1973 from 5.665182%, as reported on its 1973 return, to 5.650114%. Such a calculation results in a reduction of Westinghouse's business allocation percentage for 1972 from 6.387743% to 6.384454% and for 1973 from 6.239516% to 6.234494%. The net effect of the two adjustments for 1972 described above increased Westinghouse's business income for 1972 allocable to New

York State from $8,683,334 to $9,533,778, an increase of $850,444, with a resulting deficiency in tax for 1972 of $76,539.96. Similarly, the net effect of the adjustments for 1973 described above increased Westinghouse's business income for 1973 allocable to New York State from $2,702,912 to $4,453,304, an increase of $1,750,392, with a resulting deficiency in tax for 1973 of $157,535.28;

(c) Westinghouse was allowed credits under section 210(13) (a) of the Tax Law in the respective amounts of $2,569.77 and $6,098.22 for 1972 and 1973. Such credits were computed by first multiplying $13,390,500 and $28,110,732, representing accumulated Westinghouse DISC income for 1972 and 1973 respectively, as computed by the auditor, by 4.771297% and 5.523182%, respectively. Those percentages are the percentages of Westinghouse's receipts from export property on which Westinghouse DISC earned a sales commission and which were shipped from a regular place of business of Westinghouse in New York as compared to Westinghouse's total receipts on the sale of export property for such years for which Westinghouse DISC received a sales commission. Such total receipts amounted to $223,587,000 in 1972 and $408,080,000 in 1973.

The respective products, $638,091 for 1972 and $1,552,607 for 1973, were then multiplied by Westinghouse's revised business allocation percentages for the respective years, with the result that of the $13,390,500 and $28,110,732 includable in Westinghouse's entire net income for 1972 and 1973, respectively, only $40,790 and $96,797 respectively, were found to be eligible for credit under section 210(13) (a). These amounts were then multiplied first by 70% and then by the 9% rate of tax in effect for 1972 and 1973 to arrive at credits of $2,569.77 and $6,098.22 for 1972 and 1973, respectively.

Proceedings Below.

Westinghouse filed a petition for a redetermination of the notices of deficiency issued for 1972 and 1973. In the petition it contended that by requiring Westinghouse to compute its franchise tax liability by combining its receipts and expenses with those of Westinghouse DISC, thereby taxing accumulated DISC income and deemed distributed income of Westinghouse DISC appellees violated the Commerce Clause of the United States Constitution and the Due Process and Equal Protection Clauses of the Fourteenth Amendment. Westinghouse also contended that limiting the export credit to income attributable to shipments made from a regular place of business in New York State violated the Commerce Clause and the Equal Protection Clause. The State Tax Commission's determination denied Westinghouse's petition (App, 26a).

Westinghouse brought a proceeding in the New York Supreme Court for judicial review of the State Tax Commission's determination in which it again raised its constitutional claims. The proceeding was transferred to the Appellate Division, Third Department, for disposition (App, 18a-19a).

The Appellate Division, two Justices dissenting, held that New York Tax Law, § 208 (subd 9, par [i], subpar [B]), to the extent it requires Westinghouse DISC's accumulated income be added to Westinghouse's income, is unconstitutional on the ground that it settles an impermissible burden on foreign commerce (App, 13a-17a).

The State Tax Commission appealed from that portion of the Appellate Division's decision that invalidated section 208.9(i) (B), and Westinghouse cross-appealed to the

extent that the Appellate Division had upheld the tax on deemed distributions. Westinghouse raised the constitutional claims that it had presented before the State Tax Commission and the Appellate Division, and which it claims before this Court. The Court of Appeals rejected Westinghouse's constitutional claims and upheld the franchise tax in all respects (App, 1a-10a). Its order modified the order of the Appellate Division and reinstated the determination of the State Tax Commission (App, 10a, 27a).

ARGUMENT.

POINT I.

The New York Tax Law which imposes a tax on the consolidated income of a corporation and its wholly owned DISC subsidiary allocable to New York does not violate the commerce clause of the United States Constitution and the due process and equal protection clauses of the Fourteenth Amendment to the United States Constitution, where no showing has been made that the tax is being imposed on income of affiliates of a parent which are not doing business in New York State.

Westinghouse and Westinghouse DISC operate a unitary business. Only Westinghouse DISC's income, accumulated and deemed distributed that was allocable to New York State under its three factor allocation formula was subjected to New York taxes. Westinghouse does not attack the allocation formula nor as found by the New York Court of Appeals does the record show that Westinghouse DISC's income was improperly apportioned to business done in New York State. The record does show that the income of Westinghouse DISC was related to the

activities of Westinghouse in New York State. The record does not show that any income of Westinghouse's affiliates which do not do business in New York State was subjected to New York taxes. New York State's allocation formula excludes the income of such affiliates.

The receipts factor used by the Commission to compute Westinghouse's allocation percentage is determined by adding Westinghouse DISC's commission income derived from customers other than Westinghouse (which other customers were not subject to New York tax) to the denominator of such factors, but not to the numerator reduced Westinghouse's receipts factor. Such a calculation resulted in a reduction of Westinghouse's business allocated percentage. The calculation is designed to eliminate income of affiliates which do not do business in New York and are thus excluded from New York tax.

Recently in *Mobil Oil Corporation v. Commissioner of Taxes,* 445 U. S. 425 (1980), it was held that a state may tax apportioned dividend income of a taxpayer received from subsidiaries and affiliates operating abroad. This Court pointed out that the linchpin of apportionability for state income taxation is the unitary business principle. Apportioned profits earned by a division of a functionally integrated division of a unitary business are subject to state taxation. A state may ignore the division. between parent and subsidiary in determining the scope of a unitary business that may be subject to the state's apportioned tax on net income. Such taxation violates neither the Due Process nor the Commerce Clause of the United States Constitution (see also, *Asarco v. Idaho State Tax Comm.,*____U. S.____, 42 CCH S. Ct., Bull. p B4378 [June 29, 1982]; *F. W. Woolworth v. Taxation & Rev. Dept,*____US____, 42 CCH S. Ct., Bull. p B 4428 [June 29, 1982]).

As a matter of general principle it would seem to make little difference for purposes of state taxation whether an interstate or international unitary business is conducted by a single corporation or by a group of corporations under common ownership and control. Early cases of this Court involved corporations which were engaged in manufacturing a product in one state and selling it in others. (See, *Underwood Typewriter v. Chamberlain*, 254 U. S. 113 [1920]; *Bass, Ratliff & Gretton v. State Tax Commission*, 266 U. S. 271 [1924].) This Court concluded that it was not feasible to determine separately the profits realized in each state. Separate accounting would require the setting of prices for the transfer of the products from the manufacturing division of the business to the marketing division. Any such price would necessarily be artificial and arbitrary. The same can be said for the prices at which a manufacturing corporation sells to its wholly-owned sales subsidiaries. Under the provisions of Internal Revenue Code, §994, the pricing rules permit a DISC to make profits in excess of those which it would earn in an arm's length transaction. In such circumstances, it is proper to require that the income of the affiliated corporations be combined for purposes of apportionment. (See Keesling & Warren, *California's Uniform Division of Income for Tax Purposes Act*, 15 UCLA Intra L Rev 156 [1967]; Hellerstein, *Recent Developments in State Tax Apportionment and the Circumscription of Unitary Business*, 21 Nat'l Tax J. 487 [1968].)

As an alternate to filing a consolidated return with a DISC, a corporate taxpayer may elect to file a tax report on a combined basis with a DISC (Tax Law, §211[4]). The petitioner did not elect to file a combined report with Westinghouse DISC. If it had made the election, it would

have been taxed like other corporations. Because of intercompany transactions, if Westinghouse DISC had not elected to be taxed as a DISC, it could have been required to file a combined report with petitioner. In *Matter of Wurlitzer Company v. State Tax Commission,* 35 N. Y. 2d 100 (1974), where a foreign corporation doing business had formed a subsidiary corporation not doing business in New York to provide financing of the parent corporation, the Court held that a combined report is an accurate reflection of income subject to New York taxation. Westinghouse in the proceedings below has never shown what its tax liability would have been had Westinghouse DISC not elected to be taxed as a DISC. Accordingly, the New York tax does not violate the Due Process Clause of the Constitution. The New York tax does not conflict with the Federal regulation of foreign commerce.

Congress has the right to regulate foreign commerce. As we discussed in the statutory operation (*supra*), the history of the Federal DISC legislation demonstrates that Congress has regulated foreign commerce conducted by a DISC with regard to taxation. To promote foreign trade some Federal Tax on the income of a DISC has been deferred. However, Congress in doing so permitted the states to tax DISC income if they chose to do so. Thus, whether or not a DISC is deemed to be an instrumentality of foreign commerce, it appears that such a new holding would be irrelevant to this case. Further, no showing has been made that a DISC's income allocable to New York State is or can be subjected to international multiple taxation. For that matter there is no showing that New York allocable income of a DISC is subjected to multiple state taxation. It follows then that *McGoldrick v. Gulf Oil Corp.,* 309 U. S. 414 (1940), and *Japan Lines, Ltd. v. County of Los Angeles,* 441 U. S. 439 (1979), cited by Westinghouse in

support of its claim that the New York tax violates the Commerce Clause of the United States Constitution are inapposite. The New York tax does not interfere with foreign commerce in any manner which conflicts with the Federal government's regulation of foreign commerce but is in harmony with it.

POINT II.

The provisions of the New York State Tax Law which limit eligibility for an Export Tax Credit against taxes measured by the New York income of a DISC from the sale of export property shipped from a regular place of business in New York State do not violate the Commerce Clause of the United States Consitution and the Equal Protection Clause of the Fourteenth Amendment to the United States Constitution.

States are free to use their taxing power "to encourage the growth and development of intrastate and industry • • • [and to] compete with other states for a share of interstate commerce; such competition lies at the heart of a free trade policy." *Boston Stock Exchange v. State Tax Comm.*, 429 US 318, 336-337 (1977). Thus a state can impose a small tax or no tax on a business activity conducted within its borders to promote such activity even though the tax policy results in a business activity moving from a sister state which taxes such activity heavier.

As discussed above, New York has the right to tax Westinghouse on the New York allocated income of Westinghouse DISC. New York Tax Law §210.13(a) allows Westinghouse an export tax credit based upon the gross receipts attributable to export property shipped from the regular place of business of the taxpayer within New York.

Neither the statute nor the record demonstrates that New York is giving an impermissible commercial advantage to business done within New York at the expense of out-of-state business or activities by giving an export credit.

A tax credit cannot be applied to taxes when no taxes are imposed. The tax credit given by New York is applied to New York allocated income of Westinghouse DISC. The income of Westinghouse DISC attributable to affiliates of Westinghouse which do not do business in New York is not subject to New York taxes and is not taxed.

The record does not show that Westinghouse's New York taxes would be less if it and its affiliates increased their exports from a regular place of business of the taxpayer in New York. Since the credit only applies to exports from a regular place of business of the taxpayer in New York, an increase in Westinghouse's and its affiliates' exports from New York should result in a higher amount of its New York taxes based on the increase of New York activities and profits. In such an event the numerator of the factors used to determine the allocation percentage would be increased since its New York payroll, property and receipts would be required to be increased to facilitate shipments from New York. At the same time the denominator of the factors would decrease thus raising the New York allocation percentage. The credit merely decreases the amount of taxes which New York could impose without discriminating against a company which exports property from a place of its business without New York.

If New York is creating a tax haven, companies would be enticed to export property from New York. There is no showing that the petitioner and its affiliates or that any other company is exporting property from New York in order to take advantage of New York's export tax credit.

From all the foregoing, we submit that there is no substantial Federal question presented by this appeal.

CONCLUSION.

The appeal should be dismissed or, in the alternative, the order affirmed.

Dated: Albany, New York
July 19, 1982

Respectfully submitted,

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No. 81-2394

IN THE

Supreme Court of the United States

OCTOBER TERM, 1981

WESTINGHOUSE ELECTRIC CORPORATION,
Appellant,

-against-

JAMES H. TULLY, JR., *et al.*,
AS THE TAX COMMISSION OF THE STATE OF NEW YORK,
Appellees.

APPEAL FROM THE COURT OF APPEALS OF THE STATE OF NEW YORK

BRIEF IN OPPOSITION TO THE MOTION TO DISMISS OR AFFIRM

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No. 81-2394

In The

Supreme Court of the United States

October Term, 1981

Westinghouse Electric Corporation,
Appellant,

-against-

James H. Tully, Jr., *et. al.*,
As The Tax Commission of The State of New York,
Appellees.

APPEAL FROM THE COURT OF APPEALS OF THE STATE OF NEW YORK

BRIEF IN OPPOSITION TO THE MOTION TO DISMISS OR AFFIRM

The arguments advanced by New York State in attempting to justify its scheme for taxation of Domestic International Sales Corporations ("DISCs") fail to meet appellant's constitutional objections. Indeed, the State virtually admits that it is using taxation of Westinghouse Export to levy taxes on income earned by Westinghouse affiliates that it otherwise could not tax. Because the State lacks a sufficient nexus with these non-New York affiliates to allow it to tax them, the tax imposed by appellees violates the Commerce Clause and the Due Process Clause of the Fourteenth Amendment.

Additionally, and wholly apart from the Due Process violation, the tax is inconsistent with the Federal objective to

give tax benefits to DISCs to encourage domestic manufacture of products for export. It is inconsistent because it imposes a state tax on accumulated DISC income on which Congress has deferred tax in order to promote exports. For that reason it also violates the Commerce Clause.

Finally, the credit that New York allows against a portion of the tax otherwise due on account of DISC income is a further, independent, constitutional violation. The State has offered no justification for this credit, which penalizes international trading activities conducted from locations outside New York and rewards those conducted in New York. Such discriminatory taxation based on the location of economic activity violates the Commerce, Due Process and Equal Protection Clauses. Moreover, by encouraging export products to be shipped from New York, the State is attempting to increase the allocation percentage that it can then apply to tax non-New York affiliates through the DISC.

When all of the confusing explanations are swept away, the State's argument boils down to the claim that all of the defects that appellant has identified in the New York tax are obviated by the use of a fair apportionment formula to determine what portion of Westinghouse's income is taxable by New York. But the fact that the formula in and of itself is proper does not meet appellant's challenges. Our claim, as reiterated below, is that the formula is being applied to income that the State has no business taxing at all.

I. THE NEW YORK FRANCHISE TAX IS UNCONSTITUTIONAL BECAUSE IT IS EFFECTIVELY LEVIED ON INCOME HAVING NO NEXUS WITH THE STATE AND BECAUSE IT FRUSTRATES THE CONGRESSIONAL PURPOSE TO ENCOURAGE FOREIGN COMMERCE.

A. For purposes of analyzing constitutionality of New York's tax structure in light of the State's position here, the structure of Westinghouse's business can be divided into three relevant parts: (1) Westinghouse Electric Corporation ("West-

inghouse"), the appellant here and the taxpayer under New York law; (2) Westinghouse Electric Export Corporation ("Westinghouse Export" or "Export"), Westinghouse's wholly-owned DISC subsidiary; and (3) a number of firms affiliated with Westinghouse that—by appellees' admission—did not do any business in New York State during the years in question ("non-New York affiliates").

The State admits that the income of the non-New York affiliates must be "excluded from New York tax" (Motion to Dismiss at 13). It further admits that "[t]he income of Westinghouse [Export] attributable to affiliates of Westinghouse which do not do business in New York is not subject to New York taxes . . ." (Motion to Dismiss at 17). These concessions are required by the Commerce and Due Process Clauses, since the State has never claimed that the non-New York affiliates are part of a unitary business with Westinghouse.[1] *See ASARCO Inc. v. Idaho State Tax Comm'n*, 50 U.S.L.W. 4962 (U.S., June 29, 1982); *F. W. Woolworth Co. v. Taxation and Revenue Dep't*, 50 U.S.L.W. 4957 (U.S., June 29, 1982).

Appellees go on to claim that this income—wholly unrelated to New York—"is not taxed" by the State (Motion to Dismiss at 17). In this, appellees are wrong. For in calculating the amount of Export's income subject to New York tax, appellees include in the income base Export's entire net income, including the 20-25% earned in respect of Westinghouse's non-

[1] Indeed, the same State Tax Department Field Audit Report that recommended taxing Westinghouse on all of Export's income expressly recognized that Westinghouse's other "subsidiaries are in general, autonomous in nature with employees of their own and independent places of business. Merchandise transactions are consummated at the equivalent of 'arms length' and the taxpayer [Westinghouse] is reimbursed by its subsidiaries for services rendered on their behalf. No distortion to the New York Tax base from transactions between the parent company and other affiliated companies is evident and the financial status of each company can be independently determined." Court of Appeals Record on Appeal at 112.

New York affiliates, which amounted to $6.1 million in 1972 and $10.8 million in 1973. Appellees do not, however, include in the same calculation the payroll, property and receipts of the non-New York affiliates whose sales generated those income figures for Export in 1972 and 1973.

By ignoring the property, payroll and sales of the non-New York affiliates in calculating the apportionment formula, while using instead the apportionment formula of the New York-connected taxpayer, appellees necessarily overstate the amount of Export's income allocable to New York and reach out to tax part of that income properly allocable to business activities which have no nexus with the State. Thus, appellees are mistaken in their assertion that the constitutionality of the tax is saved because the three-factor "allocation formula excludes the income of [the non-New York] affiliates" (Motion to Dismiss at 13). In fact, the application of the formula here does not limit New York's franchise tax to amounts " 'rationally related to "values connected with the taxing state" ' ". *F. W. Woolworth Co. v. Taxation and Revenue Dep't*, 50 U.S.L.W. at 4959 (citations omitted).

Indeed, the only thing that New York claims to have done to "exclude" non-New York affiliate income is to adjust the receipts factor of its apportionment formula by adding that portion of Export's income derived from the non-New York affiliates to the denominator, but not to the numerator, of the percentage calculation (Motion to Dismiss at 9, 13). The result is a microscopic reduction in the applicable overall allocation percentage which in no way nullifies or compensates for New York's taxation of non-New York Export income. The effect of the "exclusion" relied upon by the State is to reduce Westinghouse's allocation percentage from 6.387743% to 6.384454% for 1972 (a change of .003%) and from 6.239516% to 6.234494% for 1973 (a change of .005%). The result is that, for 1972, appellees are attempting to tax over $389,000 as New York's share of Export's $6.1 million in non-New York income, but, by virtue of an allocation formula adjustment of .003%, are "giving up" taxes on only $4,920 of the total income of

Westinghouse and Export. Similarly, for 1973 appellees are imposing New York's tax on a $671,000 share of Export's $10.8 million in non-New York income, while they "give up" taxing just $3,610 of income. Thus, the State is still taxing enormous sums of Export's income arising from business activities which have absolutely no relation to New York.

As these figures demonstrate, New York's tax scheme is patently irrational. The State is including as income of Export—and therefore taxing Westinghouse upon—the income that Export derives from the receipts of the non-New York affiliates, while it is excluding from its apportionment formula the very receipts that give rise to the income it has included. New York is thus reaching out, through its allocation formula as applied to Export's income, to tax income derived from the non-New York affiliates' receipts at a substantially higher rate than is constitutionally permissible.[2]

Moreover, because New York does not have a general policy of requiring combined reporting of affiliates and subsidiary corporations,[3] its arbitrary decision to combine part of the

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[2] For the same reasons, even if the non-New York affiliates were to be considered as part of a unitary business, the New York tax would be unconstitutional. That is, proper unitary treatment of Westinghouse, Export and the non-New York affiliates would require combining *all* of the income, receipts, expenses, assets and liabilities of *all* elements of the alleged unitary business. New York, however, has only combined a selected portion of those items—the commission income earned by Export on sales on behalf of the non-New York affiliates is included, but the receipts representing the sales themselves are not. The filing of combined franchise tax report for Westinghouse and Export, as suggested by appellees (Motion to Dismiss at 14-15), would have presented the same problem.

[3] *See* N.Y. Tax Law § 211.4 ("no combined report covering any corporation not a taxpayer [*e.g.*, a non-New York affiliate] shall be required unless . . . necessary, because of inter-company transactions . . . in order properly to reflect the tax liability . . . ."). As noted above (p.3 n.1), the Tax Department's audit of Westinghouse concluded that Westinghouse's affiliate transactions were conducted on an "arm's length" basis.

income and receipts of appellant and one of its subsidiaries but not other income and receipts of other subsidiaries denies Westinghouse equal protection of the laws. Export has been singled out for uniquely harsher tax treatment. While such differential treatment of a part of Westinghouse's business is unconstitutional in itself, the problem is exacerbated by the fact that, as noted in our Jurisdictional Statement (at 14-15), the operations singled out for harsh treatment exclusively involve foreign trade. That fact justifies particularly strict scrutiny of the lines drawn by the State in taxing appellant. *See, e.g., Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434, 449 (1979).

B. In addition to these violations of the Due Process, Equal Protection and Commerce Clauses, the New York tax scheme is, quite simply, irremediably inconsistent with the tax benefits that Congress granted in enacting the DISC legislation. Beyond asserting that Congress has "permitted the states to tax DISC income"— a claim apparently based on a single, isolated quotation from a witness at a committee hearing (Motion to Dismiss at 4, 15)—appellees make no showing whatever to dispute our demonstration of inconsistency between State and Federal law (Jurisdictional Statement at 13-15). The testimony of single witness (even a Treasury official) at a committee hearing does not support an interpretation of a statute plainly at odds with its overall purpose (*see S&E Contractors, Inc. v. United States*, 406 U.S. 1, 13n.9 (1972))—here to encourage domestic manufacture of goods for export. In any event, the brief and ambiguous colloquy indicates that state taxation would be allowed, at most, only to the extent that a state "is piggybacking on the Federal corporate income tax"[4] —that is, imposing corporate taxes in the same manner as the Federal government. But New York's tax scheme is at odds

[4] Hearings Before the House Committee on Ways and Means on Tax proposals Contained in the President's New Economic Policy (92d Cong., 1st Sess.) (1970) at 171.

with the Federal structure because New York is attempting to tax the half of Export's income (its "accumulated DISC income") that is exempt from current Federal taxation.[5]

And with respect to New York's attempt to tax that portion of Westinghouse Export's income that was "deemed" distributed to Westinghouse under Federal law, but not in fact distributed (about $13 million in 1972 and $19.8 million in 1973, see Motion to Dismiss at 7), this case is controlled by last Term's decision in *F.W. Woolworth Co. v. Taxation and Revenue Dep't.* There, this Court rejected New Mexico's attempt to tax income "deemed"—for purposes of computing Federal tax—as received by a corporation from non-unitary subsidiaries, but not in fact received. 50 U.S.L.W. at 4958n.6, 4961-62. "New Mexico's effort to tax this income 'deemed received'—with respect to which New Mexico contributed nothing—" was "held to contravene the Due Process Clause." *Id.* at 4962. Similarly here, New York's attempt to tax "deemed distributions" attributable to sales by Export on behalf of non-New York affiliates, but not in fact paid as cash income to Westinghouse, must be held unconstitutional.

In sum, the New York tax fails to differentiate among the different sources of Export's income and its actual receipt by Westinghouse with sufficient precision to pass constitutional

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[5] The fact that Congress did not enact a bill dealing with this general subject in 1980 (see Motion to Dismiss at 4) is, of course, irrelevant to ascertaining its intent in passing legislation in 1971. In any event, the bill referred to by appellees, H.R. 5076 (96th Cong., 2d Sess.), would have effected a comprehensive overhaul of state taxation of foreign subsidiaries and affiliates by, among other things, generally outlawing unitary taxation of foreign affiliates where only the parent did business in a state. As part of this proposal, DISCs were to be treated as foreign corporations (even though they are incorporated domestically) and thus exempted entirely from state taxation. *See* Description of H.R. 5076 Relating to State Taxation of Foreign Source Corporate Income, prepared for the Use of the Committee on Ways and Means by the Staff of the Joint Committee on Taxation (March 28, 1980) at 18-19. Appellant has not, however, claimed that a DISC may never be taxed by New York, as H.R. 5076 would have provided. Rather, our claim is that any tax must be applied in a constitutionally proper fashion.

muster. These interrelated deficiencies, which result in a failure to identify precisely and tax only that income which the State has the constitutional power to tax, vitiate New York's entire franchise tax scheme as applied to Export's income.

II. THE NEW YORK FRANCHISE TAX UNCONSTITUTIONALLY DISCRIMINATES AGAINST EXPORTS MADE FROM OUTSIDE THE STATE.

Appellees have provided no justification whatever for their discriminatory taxation of income attributable to exports shipped from a regular place of business outside the State of New York. By virtue of New York's 70% credit against tax due on accumulated DISC income, Export pays a tax equal to 9% of its income on shipments that originate outside New York but only 2.7% of its income on shipments made from within the State. That credit plainly and undeniably discriminates against exports shipped from non-New York locations by imposing a tax on income from those sales at a rate which is more than three times higher than that imposed on exports shipped from New York.

New York defends its discriminatory taxation of non-New York based export income by relying upon the generalized statement that "States are free to use their taxing power 'to encourage the growth and development of intrastate [commerce] and industry . . . [and to] compete with other [S]tates of interstate commerce . . . .' ", citing *Boston Stock Exchange* v. *State Tax Comm'n*, 429 U.S. 318, 336-337 (1977) (Motion to Dismiss at 16). That proposition is so abstract that it says nothing about the constitutionality of a tax which is applied at higher rates to shipments made from outside the state as compared to instate shipments. Yet it is precisely such a tax which was struck down in the case relied upon by appellees. This Court in *Boston Stock Exchange* held that a New York tax on stock transactions which, *inter alia*, reduced the tax on nonresidents whose stock sales were made in New York by 50%, as compared to the tax imposed on such sales occurring

outside New York, was barred by the Commerce Clause. This Court ruled:

> "Both the maximum tax and the rate reduction provisions of § 270-a discriminate against out-of-state sales by nonresidents . . . . A state may no more use discriminatory taxes to assure that nonresidents direct their commerce to businesses within the State than to assure that residents trade only in intrastate commerce." *Id.* at 334-335.

Appellees' attempt to justify a tax rate on non-New York export income which is 333%[6] of the rate on New York export income on the ground that locating shipment activities within New York would increase the numerator of the taxpayer's three-factor apportionment formula rests on implausible assumptions and faulty logic. First, it is inconceivable that the marginal increment in the New York apportionment factors arising from the location of some shipment facilities in the State would even remotely approach offsetting a trebling of the applicable tax rate. Second, to the extent that the facilities moved to New York are removed from jurisdictions with similar apportionment formulae, taxpayers would experience an offsetting decline in their tax exposure outside New York, thereby making the credit unnecessary as a device to limit the parent corporation's total tax liability. Third, New York's argument proves far too much. If accepted, it would mean that any state with a formula-apportioned income tax could tax income derived from shipments outside the state at rates higher than those applicable to local shipments for the purpose of inducing location of shipping facilities within the taxing jurisdiction. That is precisely the kind of discriminatory taxation which was specifically condemned by this Court in the *Boston Stock Exchange* case.

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[6] 9% + 2.7% = 333%

CONCLUSION

For the foregoing reasons, and those discussed in the Jurisdictional Statement, probable jurisdiction should be noted and the case set for argument.

August 20, 1982

Respectfully submitted,

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No. 81-2394

In The

Supreme Court of the United States

October Term, 1982

WESTINGHOUSE ELECTRIC CORPORATION,
Appellant,

—against—

JAMES H. TULLY, JR., *et al.*,
AS THE TAX COMMISSION OF THE STATE OF NEW YORK,
Appellees.

ON APPEAL FROM THE COURT OF APPEALS OF THE STATE OF NEW YORK

BRIEF OF APPELLANT

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QUESTION PRESENTED

Whether the practice of the State of New York in imposing more burdensome franchise taxes on the income of the corporate parent of a Domestic International Sales Corporation ("DISC") which arises from sales shipped from facilities outside New York and sales by affiliates of the parent which do not even transact business in New York, by means of a tax credit limited in application to shipments made from facilities in New York, violates the Commerce Clause of the United States Constitution and the Due Process and Equal Protection Clauses of the Fourteenth Amendment to the United States Constitution?*

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* Westinghouse Electric Corporation was the Respondent-Appellant in the New York Court of Appeals. James H. Tully, Jr., Milton Koerner and Thomas H. Lynch, as the Tax Commission of the State of New York, were the Appellants-Respondents. A listing of all affiliates and subsidiaries of Westinghouse Electric Corporation (except wholly owned subsidiaries) appears in a Supplemental Appendix to the Jurisdictional Statement.

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—against—

JAMES H. TULLY, JR., *et al.*,
AS THE TAX COMMISSION OF THE STATE OF NEW YORK,
Appellees.

ON APPEAL FROM THE COURT OF APPEALS OF THE STATE OF NEW YORK

BRIEF OF APPELLANT

DECISIONS OF THE COURTS AND AGENCY BELOW

The opinion of the Court of Appeals of the State of New York is reported at 55 N.Y.2d 364, 434 N.E.2d 1044 and 449 N.Y.S.2d 677, and is reprinted in the Joint Appendix ("J.A.") at pages 57-66. The opinion of the Appellate Division, Supreme Court of the State of New York, Third Judicial Department, is reported at 82 A.D.2d 988 and 440 N.Y.S.2d 397, and is reprinted at J.A. 50-54. An unpublished order of the Appellate Division, dated June 29, 1981, appears at J.A. 55-

56. The unpublished order of the Supreme Court of the State of New York, Albany County, transferring the proceedings to the Appellate Division, dated January 25, 1980, appears at J.A. 48-49. The unpublished decision of the New York State Tax Commission, dated August 31, 1979, appears at J.A. 41-47.

JURISDICTIONAL BASIS OF THIS APPEAL

This is an appeal from a final judgment of the Court of Appeals of the State of New York which upheld provisions of New York law imposing a tax on the shareholders of a DISC against the contentions that the statute violated the Commerce Clause of the United States Constitution and the Due Process and Equal Protection Clauses of the Fourteenth Amendment to the United States Constitution. The judgment of the New York Court of Appeals was entered on April 1, 1982. (J.A. 67.) The Notice of Appeal was filed on June 28, 1982. Probable jurisdiction was noted, limited to Question 1 presented by the statement as to jurisdiction, on January 17, 1983. This Court has jurisdiction of the appeal by virtue of 28 U.S.C. § 1257(2).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The pertinent text of the constitutional and statutory provisions involved in this case appears in the appendix to this brief as indicated:

Article I, § 8, clause 3 (Commerce Clause) of the United States Constitution appears at page 1a.

Amendment XIV, § 1 of the United States Constitution appears at page 1a.

New York Tax Law, Article 9-A, §§ 208.1, 208.8, 208.8-A, 208.9(a), 208.9(i), 209.1, 209.6, 210.1-210.3, 210.13, 211.1 and 211.4 (McKinney 1966 & 1974 Supp.), the provisions governing the State franchise tax on DISCs as in effect during the relevant years, appear at pages 1a-12a.

STATEMENT OF THE CASE

A. The Statutory Framework.

As part of the Revenue Act of 1971, Congress—with the intention to "provide tax incentives for U.S. firms to increase their exports" and thereby to "improve our balance of payments"[1]—authorized the establishment of a unique new corporate entity known as a "Domestic International Sales Corporation" or "DISC". Internal Revenue Code of 1954 ("I.R.C."), 26 U.S.C. §§ 991-997 (1967 & 1974 Supp.). A corporation qualifies as a DISC if substantially all of its assets and gross receipts are export related. I.R.C. §§ 992(a), 993.

Under the DISC provisions of the I.R.C. in effect in 1972 and 1973, the tax years here in question, and as relevant here, the income of a DISC was not taxed to the DISC at all. I.R.C. § 991. Instead, a portion of the DISC's income was taxed to the DISC's shareholder, I.R.C. § 995(a), which is typically the corporate parent of the DISC. A minimum of one-half of the DISC's income was taxed to its shareholders on a current basis whether or not it was actually paid or distributed to the shareholders (this income is known as "deemed distributions"). I.R.C. § 995(b). Taxes on the remaining income of the DISC were deferred until either that remaining income (known as "accumulated DISC income") was actually distributed to the DISC's shareholders or the DISC no longer qualified for special tax treatment. I.R.C. § 995. Effectively, then, up to one-half of a DISC's income was not taxed at all under the 1971 Act for as long as it was retained by the DISC.

In response to the Federal DISC legislation, New York in 1972 enacted the tax statute at issue here, 1972 N.Y. Laws, chs. 778, 779 (codified at N.Y. Tax Law §§ 208-219-a (McKinney 1966 & 1974 Supp.)), as an amendment to its general corpo-

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[1] H.R. Rep. No. 92-533 (92d Cong., 1st Sess.), *reprinted in* 1971 U.S. Code Cong. & Ad. News 1825, 1831; S. Rep. No. 92-437 (92d Cong., 1st Sess.), *reprinted in* 1971 U.S. Code Cong. & Ad. News 1918, 1928.

rate franchise tax. New York imposed its franchise tax based on the *total* income of a DISC. That is, New York taxed both deemed distributions from DISCs (which were subject to Federal tax) *and* accumulated DISC income (as to which all Federal tax was deferred). Moreover, in practical effect, New York also imposed its franchise tax on income of a DISC with respect to sales having no relation to New York by *including* in its computation of the DISC's income revenues derived from sales of affiliates not doing business in New York, while *excluding* the receipts, property and payroll of those affiliates from its apportionment calculations.

To cushion the effect of imposing a State tax on accumulated DISC income that was tax-free under Federal law, New York set the effective tax rate on such income at just 30% of the rate generally applicable under the franchise tax. This lower tax rate is afforded by means of granting a "DISC export credit". N.Y. Tax Law § 210.13(a). The credit is subject, however, to a limitation which is the focus of this appeal: The credit and concomitant reduced tax rate are available only with respect to gross receipts from products "shipped from a regular place of business of the taxpayer within [New York] state". N.Y. Tax Law § 210.13(a)(2).

Accumulated DISC income derived from shipments of products from locations in the United States outside of New York, including shipments by affiliates which do no business and have no contacts with New York, is taxed at the full corporate franchise tax rate. The express purpose of so limiting the DISC export credit to shipments made from New York was to encourage export sales to be made through facilities located in New York State. *See infra* pp. 13-14.

B. The Taxpayer and the Disputed Tax Assessment.

As stipulated by the parties below (J.A. 42-47), appellant Westinghouse Electric Corporation ("Westinghouse") is a Pennsylvania corporation engaged in the manufacture and sale of such products as electrical equipment, parts and appliances.

Westinghouse is qualified to and does business in New York, regularly paying corporate income and franchise taxes to the State. Westinghouse has a number of United States affiliates, however, which—as stipulated by appellees—do not do any business in New York ("non-New York affiliates"). (J.A. 4-5, 42-43.)

Westinghouse owns all of the stock of Westinghouse Electric Export Corporation ("Westinghouse Export" or "Export"), which qualifed as a DISC under I.R.C. § 992(a) in 1972 and 1973. Westinghouse Export acted as a commission agent on behalf of both Westinghouse and its non-New York affiliates for export sales of products manufactured in the United States and related services during 1972 and 1973. As stipulated, all of Export's income consisted of commissions on such sales. Under I.R.C. § 991, Westinghouse Export was exempt from Federal income tax for those years. In 1972 and 1973, Westinghouse Export had no employees in New York, did not engage in any business activities or maintain an office in New York, employed no capital in New York, did not own or lease real or tangible personal property in New York, paid no real estate rentals in New York, and did not file a New York corporate franchise tax return. (J.A. 42-43.)

Westinghouse Export's total income in 1972 was just under $26 million; of this amount, approximately one-quarter was received from Westinghouse-affiliated companies not doing business in New York and the remainder was received from Westinghouse itself.[2] On its 1972 Federal income tax return, pursuant to I.R.C. § 995(b), and on its 1972 New York State franchise tax return, Westinghouse included as income, and paid taxes upon, an amount of deemed distribution income equal to about one-half of Export's total income (or just under $13 million).[3] Similarly, in 1973, the income of Westinghouse

[2] Total Westinghouse Export income for 1972 was $25,987,000, of which $19,888,000 was received from Westinghouse and $6,099,000 from non-New York affiliates. (J.A. 16, 43.)

[3] The exact amount of income deemed distributed to Westinghouse by Export in 1972 was $12,956,500. (J.A. 43.)

Export was nearly $58 million, of which almost one-fifth was received from non-New York affiliates and the remainder from Westinghouse; $29.8 million of Export's income was deemed distributed to Westinghouse under I.R.C. § 995(b), was subject to Federal income tax and was reported on Westinghouse's New York State franchise tax return.[4] In both 1972 and 1973, Westinghouse incurred no Federal income tax liability for the approximately one-half of Export's income—its accumulated DISC income—that was not deemed distributed to Westinghouse.

This case arose when the New York State Tax Commission (whose members are appellees here) sought to include in Westinghouse's "entire net income" subject to the State franchise tax for 1972 and 1973 not only the amounts subject to Federal tax, but also the accumulated DISC income not subject to current Federal taxation. The State Tax Commission computed Westinghouse's franchise tax by combining all of Westinghouse Export's income, including that derived from sales by Westinghouse's non-New York affiliates, with that of Westinghouse pursuant to N.Y. Tax Law § 208.9(i)(B).

In apportioning Westinghouse Export's income to New York, however, the Commission excluded the receipts, property and payroll of Westinghouse's non-New York affiliates from the apportionment formula, thereby subjecting all of Export's income derived from sales on behalf of affiliates to the New York corporate franchise tax. By this procedure, the Commission taxed income that was earned by Export entirely through sales on behalf of Westinghouse's non-New York affiliates which, as noted, do not do business in the State.

Westinghouse's liability for tax on Export's accumulated DISC income was reduced by operation of the "export credit"

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[4] More precisely, Export's 1973 income was $57,948,738, of which $47,180,132 was received from Westinghouse and $10,768,606 from non-New York affiliates. Deemed distributions from Export to Westinghouse were $29,838,006, on which the latter paid Federal income and State franchise taxes. (J.A. 16, 43.)

pursuant to N.Y. Tax Law § 210.13(a). The amount of that credit was subject to a limitation (under N.Y. Tax Law § 210.13(a)(2)) based on the extent to which Export's income was attributable to shipments made from a regular place of business in New York. Only about 5% of Export's receipts came from such New York shipments. As a result, the Commission alleged deficiencies in Westinghouse's franchise tax payments of $71,970 for 1972 and $151,436.76 for 1973. (J.A. 14-15, 29, 44-47.)

C. The Proceedings Below.

In response to the State Tax Commission's notices of deficiency for 1972 and 1973, Westinghouse filed a petition, and later a perfected petition, for redetermination. (J.A. 19-28.) The perfected petition contended that, by requiring Westinghouse to compute its franchise tax liability by combining all of the receipts and expenses of Westinghouse Export with its own, thereby taxing income with which "New York lacked a jurisdictional nexus", appellees violated the Commerce Clause of the United States Constitution and the Due Process Clause of the Fourteenth Amendment. (J.A. 26.) Westinghouse also contended that limiting the tax benefits effected by the export credit to income attributable to shipments from New York violated the Commerce, Due Process and Equal Protection Clauses. (J.A. 27.) The State Tax Commission rejected Westinghouse's contentions, concluding that "the constitutionality of the laws of the State of New York is presumed at the administrative level." (J.A. 47.)

Westinghouse reiterated all of its constitutional claims against the franchise tax in a petition to the New York Supreme Court under Article 78, N.Y.C.P.L.R. (McKinney 1981), for review of the findings of the State Tax Commission. The Supreme Court transferred the proceedings to the Appellate Division, Third Judicial Department, for disposition. (J.A. 48-49.)

The Appellate Division, two justices dissenting, struck down a portion of the franchise tax. It held that N.Y. Tax Law § 208.9(i)(B) unconstitutionally burdened foreign commerce because it taxed accumulated DISC income which Congress had intended to exempt from all current taxation. This decision made it unnecessary for the Appellate Division to consider the constitutionality of New York's geographical limitation on the DISC export credit, because the credit itself applies only to accumulated DISC income. The Appellate Division went on to reject Westinghouse's constitutional challenges to New York's taxation of deemed distribution income. (J.A. 50-54.)

The State Tax Commission appealed from that portion of the Appellate Division decision invalidating section 208.9(i)(B), and Westinghouse cross-appealed from that portion upholding taxation of deemed distributions. Westinghouse again raised the constitutional arguments that it had presented to the State Tax Commission and the Appellate Division. The Court of Appeals rejected Westinghouse's constitutional claims and upheld the franchise tax in all respects. (J.A. 57-66.) Its judgment reversed the Appellate Division in part and reinstated the determination of the State Tax Commission. (J.A. 66, 67.)

SUMMARY OF ARGUMENT

The Federal DISC tax legislation was intended "to provide substantial stimulus" by way of "tax incentives for U.S. firms to increase their exports."[5] It did so by exempting qualifying DISCs (corporations which receive substantially all of their income from export transactions) from all tax, while taxing only about one-half of their income currently to their shareholders and indefinitely deferring the tax on the remaining "accumulated DISC income".

New York State, in order to subject DISC income to its franchise tax, required corporate taxpayers to consolidate the income of a DISC with that of its parent company. The franchise tax was then assessed against such total combined income, including any income derived by the DISC from other subsidiaries of the parent even if they did no business in New York and were not otherwise part of a unitary business with the parent. Fearing that taxing DISC income at the full New York franchise tax rate would discourage export trading activity in the State, New York enacted a credit applicable to the tax payable on accumulated DISC income, but limited that credit to income derived from exports shipped from a place of business in the State.

By limiting the DISC export credit to shipments made from within the State, New York violates the Constitution. The limitation on the credit provides a "direct commercial advantage to local business" in contravention of the Commerce Clause. *Maryland v. Louisiana*, 451 U.S. 725, 754 (1981). It provides such an advantage, and at the same time discriminates against export trade conducted from locations in other states, by taxing accumulated DISC income derived from out-of-state shipments at a rate more than three times that imposed on in-

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[5] H.R. Rep. No. 92-533, *supra* note 1, 1971 U.S. Code Cong. & Ad. News at 1872; S. Rep. No. 92-437, *supra* note 1, 1971 U.S. Code Cong. & Ad. News at 1928, 1996.

state shipments. Such discrimination is "virtually *per se* illegal." *Boston Stock Exchange v. State Tax Commission*, 429 U.S. 318, 336 (1977).

The lower court's justification of New York's limitation on the credit as providing "State tax incentives akin to" those of the Federal law to "ensure" New York's "competitive position vis-a-vis other states" (J.A. 63-64), conflicts with the basic purpose of the Commerce Clause. Indeed, the Commerce Clause was enacted precisely to prevent establishment of the sort of "preferential trade area" which New York has sought to create here. *Maryland v. Louisiana*, 451 U.S. at 754.

Nor can the limitation on the export credit be justified, as the Court of Appeals sought to do, on the grounds that the State is merely taxing a properly allocated fraction of the DISC's income and then forgiving some of the tax which it is entitled to levy. First, the Constitution is violated equally whether it is a tax or a credit which causes a discriminatory impact on commerce. Second, the apportionment formula as applied to the limited credit actually exacerbates the constitutional violation. While all of Export's income, including approximately 20-25% earned in transactions on behalf of Westinghouse affiliates which do no business in the State, is subjected to the New York tax, the denominator of the State's apportionment formula does not include the out-of-state payroll, property and receipts of those affiliates. New York is thereby taxing an excessive share of Export's income earned from non-New York sources, a fact which, when combined with the limitation on the credit, provides a powerful incentive to shift export operations to the State. The Constitution plainly proscribes this kind of discriminatory tax incentive.

ARGUMENT

THE NEW YORK FRANCHISE TAX UNCONSTITUTIONALLY BURDENS INTERSTATE COMMERCE AND DISCRIMINATES AGAINST FIRMS EXPORTING PRODUCTS FROM OUTSIDE THE STATE BY SUBJECTING NEW YORK'S SHARE OF THEIR INCOME TO A GREATER TAX THAN THE SAME AMOUNT OF NEW YORK INCOME IN THE HANDS OF A PERSON WHO EXPORTS PRODUCTS FROM WITHIN NEW YORK STATE.

A. The Background of Federal DISC Legislation.

This case brings before the Court for the first time on plenary review a case arising out of the DISC provisions of the Internal Revenue Code.[6] As noted above, these provisions were originally enacted in 1971 because Congress concluded that "it is important to provide tax incentives for U.S. firms to increase their exports."[7] By this means, among others, Congress sought to "increase the number of jobs and diminish the high unemployment rate" in the United States and to "improve our balance of payments".[8] *See Caterpillar Tractor Co. v. United States,* 589 F.2d 1040, 1044 (Ct. Cl. 1978).

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[6] 26 U.S.C. §§ 991-997, added by the Revenue Act of 1971, Pub. L. No. 92-178, Title V, 85 Stat. 535 (1971). The DISC statute was amended in some respects after the tax years in question in this case by the Tax Reduction Act of 1975, 89 Stat. 26, and the Tax Reform Act of 1976, 90 Stat. 1525. *See generally* United States Department of the Treasury, 1980 Annual Report: The Operation and Effect of the Domestic International Sales Corporation Legislation 3-6 (December 1982) [hereinafter "DISC Report"].

[7] H.R. Rep. No. 92-533, *supra* note 1, 1971 U.S. Code Cong. & Ad. News at 1872; S. Rep. No. 92-437, *supra* note 1, 1971 U.S. Code Cong. & Ad. News at 1996.

[8] S. Rep. No. 92-437, *supra* note 1, 1971 U.S. Code Cong. & Ad. News at 1918.

To serve these national goals, the DISC legislation was designed not only "to provide substantial stimulus to exports",[9] "but also to remove a present disadvantage of U.S. companies engaged in export activities through domestic corporations".[10] Prior to enactment of the Federal DISC provisions, such firms were "treated less favorably than [American firms] which manufacture abroad through the use of foreign subsidiary corporations".[11] *See also Caterpillar Tractor Co. v. United States,* 589 F.2d at 1044. In the former case, the United States corporation was fully and immediately taxable on its entire income from export sales. In the latter case, foreign tax might be minimal and United States tax was imposed only when (and if) income was remitted to the United States parent as a dividend. In addition, Congress recognized that "other major trading nations encourage foreign trade by domestic producers in one form or another", and the DISC statute was therefore aimed at "removing discrimination against those who export through U.S. corporations".[12]

For these reasons, Congress created the DISC. It established the statutory requirements for eligibility for special tax treatment, *see* I.R.C. §§ 992, 993, as well as more flexible intercompany pricing and commission rules, I.R.C. § 994. Congress exempted qualifying DISCs from taxation, I.R.C. § 991, while taxing only a portion (approximately 50%) of the DISC's income currently to its shareholders as "deemed distributions" and deferring indefinitely the tax on the remaining accumulated DISC income, I.R.C. § 995.

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[9] *Id.* at 1928.

[10] H.R. Rep. No. 92-533, *supra* note 1, 1971 U.S. Code Cong. & Ad. News at 1872; S. Rep. No. 92-437, *supra* note 1, 1971 U.S. Code Cong. & Ad. News at 1996.

[11] S. Rep. No. 92-437, *supra* note 1, 1971 U.S. Code Cong. & Ad. News at 1996.

[12] *Id.*

There can be no doubt of the economic significance of the Federal DISC legislation. According to Treasury Department statistics, as of 1980 there were over 7,900 DISCs with total gross receipts of nearly $132 billion, net income of $8.4 billion and tax deferred income of over $3 billion.[13] The Treasury estimated that the existence of the DISC legislation resulted in an increase in United States exports in 1980 of between $6.2 billion and $9.4 billion.[14]

B. The New York Tax Scheme for DISCs.

After enactment of the Federal DISC legislation, New York officials believed that, because of the manner in which the State franchise tax is structured, some provision for taxing DISCs would have to be made in order to avoid substantial revenue losses. For example, because New York does not generally impose its franchise tax on distributions received by a parent from a subsidiary (the subsidiary having been taxed directly to the extent that it does business in the State), a DISC's dividends would not have been taxable.[15] The State Budget Division noted that if DISCs were not taxed at all, New York might suffer revenue losses of as much as $20 to $30 million annually. *See* Budget Report, *supra* note 15, at 20.

On the other hand, the State was afraid that "full taxation of DISCs would undoubtedly encourage their formation outside the State, in states such as New Jersey, Connecticut and Massachusetts. If the DISC were formed outside of the State, its income might not be subject to any tax in New York." Budget Report, *supra* note 15, at 18. Accordingly, New York chose to require, in effect, the consolidation of the receipts,

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[13] DISC Report, *supra* note 6, at 28 (Table 5-2).

[14] *Id.* at 1.

[15] *See* New York Division of the Budget, Report on A. 12108-A and S. 10544 (May 23, 1972), *reprinted in* Bill Jacket of 1972 N.Y. Laws, ch. 778, at 13, 17-18 [hereinafter "Budget Report"].

assets, expenses and liabilities of the DISC and its parent company. N.Y. Tax Law § 208.9(i) (B).[16] The franchise tax was then to be assessed against the parent on the basis of the consolidated amounts, subject to various adjustments not relevant here. In addition, because "full taxation of DISC income to shareholders could detract from manufacturing of export goods within New York State", New York provided "a partially offsetting tax credit". Budget Report, *supra* note 15, at 18. But—with the express intention to "provide a positive incentive for increased business activity in New York State", Budget Report, *supra* note 15, at 18—New York limited this DISC export credit to income derived from exports shipped from a place of business within the State. N.Y. Tax Law § 210.13(a)(2). The limited export credit was to be a "tax advantage" that "would increase as the sales . . . of products from New York sources increase—a situation that provides an incentive to remain and possibly expand business in this state" and that would "encourage the continued development of export trade through the Port of New York", while maintaining New York's "competitive position in regard to the expansion of manufacturing facilities with neighboring states." Commerce Memorandum, *supra* note 16, at 11.

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[16] *See* New York Department of Taxation & Finance, Letter to Honorable Nelson A. Rockefeller (June 2, 1972), *reprinted in* Bill Jacket of 1972 N.Y. Laws, ch. 778, at 2, 5; New York Department of Commerce, Memorandum Recommending Approval of Assembly Bill 12108-A (May 24, 1972), *reprinted in* Bill Jacket of 1972 N.Y. Laws, ch. 778, at 9, 11 [hereinafter "Commerce Memorandum"].

C. New York's Taxation of DISCs Unconstitutionally Burdens Interstate Commerce and Discriminates Against Foreign Commerce Activity Conducted in States Other than New York.

As its legislative history makes clear, the purpose of limiting the DISC export credit was to pressure firms engaged in the export trade to locate operations in New York State. The Court of Appeals expressly recognized this:

> "The credit was devised . . . to provide shareholders of DISCs with State tax incentives akin to those that had been enacted by the Federal Government. Such credit was intended to ensure that New York would not lose its competitive position vis-a-vis other States which were also expected to offer tax benefits to DISC owners." (J.A. 63-64; citations omitted.)

The Court of Appeals failed, however, to recognize that the express legislative purpose of the New York tax, as well as its inevitable practical effect, is subversive of the most fundamental economic principles embodied in the Federal Constitution:

> "[N]o State, consistent with the Commerce Clause, may impose a tax which discriminates against interstate commerce . . . by providing a direct commercial advantage to local business. *Northwestern States Portland Cement Co. v. Minnesota,* 358 U.S. 450, 458 (1959). *See Boston Stock Exchange v. State Tax Comm'n,* 429 U.S. 318, 329 (1977)." *Maryland v. Louisiana,* 451 U.S. at 754.

As will be shown below, the New York tax provides precisely the forbidden "direct commercial advantage to local business."

The primary error in the analysis used by the Court of Appeals lies in its confusion of a State's powers in the area of economic development with those of the Federal government. It is, of course, constitutionally proper for the Federal government to encourage American firms to manufacture products for export by means of tax benefits such as those embodied in the DISC statute. By this means, the national government may

seek to increase domestic employment and improve our balance of payments, even at the expense of our trading partners overseas. If electric generators (to use appellant's products as an example) can thereby be manufactured more economically in Pittsburgh for shipment to Latin America, it is to be hoped that American workers will gain jobs, albeit at the cost of some employment in Japan or Germany.

But the Constitution does not permit a State to encourage the development of local industry by means of taxing measures which impose greater burdens on economic activities taking place outside the State than are imposed on similar activities within the State. Indeed, the "basic purpose" of the Commerce Clause is "to prohibit the multiplication of preferential trade areas destructive of the free commerce anticipated by the Constitution." *Maryland v. Louisiana*, 451 U.S. at 754 (citing *Boston Stock Exchange v. State Tax Commission*, 429 U.S. at 356). It is this "basic purpose" of which the court below lost sight.

This Court has not hesitated to strike down State taxes violative—as New York's is— of this principle. For example, in *Maryland v. Louisiana*, 451 U.S. at 725, Louisiana imposed a tax on the "first-use" of natural gas brought into the State which had not previously been taxed by another State or by the United States. Through a number of exemptions and credits, however, Louisiana users of natural gas were generally not burdened by the tax, while it uniformly applied to gas moving out of the State to consumers in the rest of the country. 451 U.S. at 732-33. The Court struck down this tax scheme, holding that it "unquestionably discriminates against interstate commerce in favor of local interests". 451 U.S. at 756.

Similarly, in *Boston Stock Exchange v. State Tax Commission*, 429 U.S. at 318, New York had amended its stock transfer tax so that (a) the tax payable by nonresidents was reduced by 50% when the transaction involved an in-state sale but not when it involved an out-of-state sale and (b) a maximum tax of $350 was applied to a single transaction (by either a resident or

a nonresident) when the sale took place in-state but not when it took place elsewhere. This transfer tax amendment was held unconstitutional. Because it "foreclose[d] tax-neutral decisions and create[d] both an advantage for the [stock] exchanges located in New York and a discriminatory burden on commerce to its sister States", 429 U.S. at 331, the tax violated the principle that "no State may discriminatorily tax the products manufactured or the business operations performed in any other State", 429 U.S. at 337.

This case is controlled by *Boston Stock Exchange* and *Maryland v. Louisiana*. Not only is there discrimination against commerce carried on out-of-state, but even the discriminatory purpose expressed in the legislative history here, *see supra* pp. 13-14, parallels that noted in *Boston Stock Exchange*, *see* 429 U.S. at 323-28. The purpose and effect of New York's limitation of the DISC export credit to in-state export shipments is clear: The same amount of accumulated DISC income is taxed at a lower rate if the taxpayer chooses to export its products from a place of business located in New York rather than in another State. Thus, for the years in question here, New York's share of the accumulated DISC income earned by Westinghouse Export was taxed at a rate of 9% to the extent that export shipments were made from outside New York State, but only 2.7%[17] on shipments made from within the State. Put another way, a corporation with accumulated DISC income of $1,000, half of which is allocable to New York, would owe $45 in tax if it shipped its exports from facilities located in New Jersey. However, a firm with the same $1,000 of accumulated DISC income, of which the same one-half is allocable to New York—but shipping its products from the east side of the Hudson River—would owe just $13.50 in tax.[18] As in *Boston*

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[17] The relevant tax rate in 1972 and 1973 was 9%. N.Y. Tax Law § 210.1(a)(1). The DISC export credit is equal to 70% of the tax rate. N.Y. Tax Law § 210.13(a)(5).

[18] This amount is calculated by multiplying the accumulated DISC income ($1,000) by the New York allocation percentage (50%) and by the tax rate (9%), then subtracting a credit equal to

Stock Exchange, this differential taxation "forecloses tax-neutral decisions and . . . creates an advantage" for firms operating in New York and "a discriminatory burden on commerce to its sister States". 429 U.S. at 331.[19]

The Commerce Clause forbids precisely this sort of attempt to use discriminatory taxation to require " 'business operations to be performed in the home State that could more efficiently be performed elsewhere.' " *Boston Stock Exchange*, 429 U.S. at 336 (quoting *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 145 (1970)). Indeed, " '[e]ven where the State is pursuing a clearly legitimate local interest, this particular burden on commerce has been declared to be virtually *per se* illegal.' " *Id.* As *Pike v. Bruce Church, Inc.* makes clear, moreover, the fact that legislation was intended "to preserve or secure employment for the home State", as it was here, is further proof of unconstitutionality. 397 U.S. at 145-46. A State may not use the power to tax or to regulate business " 'to divert to [itself] employment and business which might otherwise go' " elsewhere; " 'the necessary tendency' " of such enactments " 'is to impose an artificial rigidity on the economic pattern of the

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70% of the tax: $1,000 × 50% × 9% = $45. $45 – ($45 × 70%) = $45 – $31.50 = $13.50. For simplicity, it is assumed that all of the taxpayer's exports are made either from in-state or out-of-state.

[19] The same result is required under the Equal Protection Clause of the Fourteenth Amendment. By limiting the export credit to in-state shipments, New York fails to treat export businesses operating across state lines in the same manner as such businesses operating entirely within New York. But once a State allows foreign corporations to do business within its borders, "the adopted corporations are entitled to equal protection with the state's own corporate progeny". *Wheeling Steel Corp. v. Glander*, 337 U.S. 562, 571 (1949). As Justice Brennan has explained:

> "*Wheeling* applied the Equal Protection Clause to give effect to its role to protect our federalism by denying Ohio the power constitutionally to discriminate in favor of its own residents against the residents of other state members of our federation." *Allied Stores, Inc. v. Bowers*, 358 U.S. 522, 533 (1959) (Brennan J., concurring).

See also Concordia Fire Ins. Co. v. Illinois, 292 U.S. 535, 545-47 (1934); *Hanover Fire Ins. Co. v. Harding*, 272 U.S. 494, 507-08 (1926); *Southern Ry. v. Greene*, 216 U.S. 400, 412, 417-18 (1910).

industry.'" *Id.* at 147 (quoting *Toomer v. Witsell*, 334 U.S. 385, 403-04 (1948)).

In short, the limitation of the franchise tax credit in N.Y. Tax Law § 210.13(a)(2) is unconstitutional because it diverts the natural flow of our nation's interstate commerce to New York from locations in other States from which exporters may find it more economical to ship. Such a burden on interstate commerce must be struck down "when the avowed purpose of the obstruction, as well as its natural tendency, is to suppress or mitigate the consequences of competition between the states." *Baldwin v. G.A.F. Seelig, Inc.*, 294 U.S. 511, 522 (1935).[20]

Despite the patently discriminatory purpose and effect of the limited DISC export credit, the Court of Appeals upheld it as an instance of legitimate competition with other States because "the business allocation percentage plays an integral role in computing the tax credit." (J.A. 65.) Using the allocation percentage, according to the Court of Appeals, means that "when the State exercises its taxing power, it does so consistently with due process mandates". (J.A. 65.) Thus, the court argued, by limiting the DISC export credit to in-state shipments, the State "simply forgives a portion of that income which New York may tax by reference to shipments of export property from a regular place of business in New York, an additional New York relationship." (J.A. 65.)

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[20] Justice Cardozo went on to recognize in the *Baldwin* case— a case which this Court found to be "particularly relevant to" its decision in *Boston Stock Exchange v. State Tax Commission*, 429 U.S. at 335 n.14—that State laws must fall when they "would neutralize the economic consequences of free trade among the states":

> "What is ultimate is the principle that one state in its dealings with another may not place itself in a position of economic isolation. . . . Neither the power to tax nor the police power may be used . . . with the aim and effect of establishing an economic barrier against competition with the products of another state or the labor of its residents."

Baldwin v. G.A.F. Seelig, Inc., 294 U.S. at 526, 527.

In so ruling, the Court of Appeals overlooked two crucial problems. First, the court's premise that the State's use of the allocation formula satisfied any due process concerns was unfounded. In fact, the State's taxation of DISC income derived from the activities of Westinghouse's non-New York affiliates, coupled with its exclusion of those affiliates' receipts, property and payroll from the apportionment formula, violates the Due Process Clause. Second, "forgiveness" does not cure a discrimination which arises from the act of forgiving. The fact that appellees may tax real property situated in the State of New York does not justify a tax credit limited to a single race of landowners.

The Court of Appeals' argument that "New York need not tax all which it has the right to tax" (J.A. 65) simply begs the question. The fact that New York discriminates against exports shipped from other States by disallowing a tax credit for such shipments, rather than by some other means, is constitutionally irrelevant. A "state tax must be assessed in light of its actual effect considered in conjunction with other provisions of the State's tax scheme." *Maryland v. Louisiana*, 451 U.S. at 756. The question is " 'whether the statute under attack, whatever its name may be, will in its practical operation work discrimination against interstate commerce.' " *Id.* (quoting *Best & Co. v. Maxwell*, 311 U.S. 454, 455-56 (1940)). The logic used by the Court of Appeals is foreclosed by *Maryland v. Louisiana*, where a uniform tax was held to be unconstitutional because discrimination against interstate commerce was "the necessary result of various tax credits and exclusions" which benefitted only in-state consumers of gas. 451 U.S. at 756. It is enough that the limitation of the DISC export credit will "in its practical operation work discrimination". *Id.*[21]

Indeed, the theory enunciated by the Court of Appeals could be used to justify any discriminatory tax so long as the

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[21] *See also Mapco, Inc. v. Grunder*, 470 F.Supp 401, 406, 411-14 (N.D. Ohio 1979) (striking down Ohio tax on in-state use of low-sulfur coal because virtually all such coal was imported from other States while Ohio produced only high-sulfur coal).

legislature first levied a proper tax and then forgave a portion of it only to the favored few. But the class whose tax is forgiven also must be chosen in a constitutionally legitimate manner. New York would never contend that, since it may constitutionally impose an equal sales tax on all transactions within the State, it could also forgive 70% of that tax when a sale was made by a merchant belonging to a particular racial or religious group. Similarly, the Commerce Clause guarantees substantially equal treatment to an export business whether it is conducted inside or outside of New York.

In addition, as noted above, the discriminatory effect of limiting the DISC export credit to New York shipments is exacerbated because, in calculating the franchise tax and credit, New York requires that the income and expenses of a DISC be collapsed into those of its parent. For Westinghouse, this requirement means that it is taxed on that portion of Export's income—20-25% during the years in question—which is derived from export sales on behalf of Westinghouse affiliates which do no business whatsoever in New York. *See supra* pp. 5-6 & nn. 2-4.[22] But because the combination requirement for DISC taxation includes only Westinghouse and Export—and not the non-New York affiliates—the apportionment percentage (by which the combined income figure is multiplied to allocate New York's share of income) is too high. That is, while the income total includes Export's income earned in

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[22] Appellees have never claimed that Westinghouse's non-New York affiliates are part of a unitary business with Westinghouse or are otherwise taxable in New York. Indeed, the same State Tax Department Field Audit Report that recommended taxing Westinghouse on all of Export's income expressly recognized that Westinghouse's other "subsidiaries are, in general, autonomous in nature with employees of their own and independent places of business. Merchandise transactions are consummated at the equivalent of 'arms length' and the taxpayer [Westinghouse] is reimbursed by its subsidiaries for services rendered in their behalf. No distortion to the New York Tax base from transactions between the parent company and other affiliated companies is evident and the financial status of each company can be independently determined." (J.A. 12.)

respect of Westinghouse's non-New York affiliates—$6.1 million in 1972 and $10.8 million in 1973—the apportionment formula is not adjusted to include the payroll, property and receipts of the non-New York affiliates whose sales generated that income for Export. Since, by definition, the non-New York affiliates have no payroll, property or receipts in New York, this omission from the allocation formula of the amounts of such factors attributable to them means that the denominator of the formula is too small and the resulting percentage too high.

Thus, by ignoring the property, payroll and receipts of the non-New York affiliates in calculating the apportionment formula, while using instead the combined apportionment formula of Westinghouse and Export, appellees necessarily overstate the amount of Export's income allocable to New York. In so doing, they reach out to tax part of Export's income which is allocable entirely to business activities which have no nexus with the State. While this constitutes an independent constitutional violation,[23] it is significant here because it constitutes an additional means by which New York pressures corporate taxpayers to shift business activities from outside the State to places of business within New York. Again, "in its practical operation", the New York DISC taxation scheme "work[s] discrimination against interstate commerce". *Maryland v. Louisiana*, 451 U.S. at 756.

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[23] Because of the defects identified in the text in New York's application of its apportionment formula to the Westinghouse/Export combination, New York fails to limit its franchise tax to amounts " 'rationally related to "values connected with the taxing state" ' ". *F.W. Woolworth Co. v. Taxation & Revenue Dep't*, 102 S. Ct. 3128, 3134-35 (1982) (citations omitted).

CONCLUSION

For the foregoing reasons, New York's method of taxing accumulated DISC income derived from the sales of Westinghouse shipped from points outside New York and the sales of its affiliates which do not do business in New York should be declared violations of the Commerce Clause of the United States Constitution and the Equal Protection and Due Process Clauses of the Fourteenth Amendment. The judgment of the Court of Appeals should be reversed and the case remanded for assessment of Westinghouse's franchise tax liability in accordance with controlling constitutional principles.

May 2, 1983

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CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

UNITED STATES CONSTITUTION

Article I, Section 8

The Congress shall have Power . . .

[3] To regulate Commerce with foreign Nations, and among the several States and with the Indian Tribes.

Amendment 14, Section 1

All persons born or naturalized in the United States, and subject to the jurisdiction thereof, are citizens of the United States and of the States wherein they reside. No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States, nor shall any State deprive any person of life, liberty or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.

NEW YORK TAX LAW, ARTICLE 9-A

(as in effect in 1972 and 1973)

New York Tax Law § 208.

As used in this Article:

1. The term "corporation" includes a joint-stock company or association and any business conducted by a trustee or trustees wherein interest or ownership is evidenced by certificate or other written instrument; a "DISC" and a "former DISC" mean any corporation which meets the requirements of subsection (a) of section nine hundred ninety-two of the internal revenue code of nineteen hundred fifty-four. . . .

New York Tax Law §§ 208.8, 208.8-A

8. The term "business income" means entire net income minus investment income;

8-A. Provided, however, that with respect to a DISC or a former DISC, the following provisions shall apply:

(a) investments in the stocks, bonds or other securities of a DISC or any indebtedness from a DISC shall not be treated as either subsidiary capital or investment capital under subdivisions four or five of this section,

(b) any amounts deemed distributed from a DISC or a former DISC which are taxable as dividends pursuant to subsection (b) of section nine hundred ninety-five of the internal revenue code of nineteen hundred fifty-four shall be treated as business income, except any such amounts from a former DISC attributable to amounts includible in a taxpayer's entire net income for a prior taxable year under subparagraph (B) of paragraph (i) of subdivision nine of this section shall be excluded from entire net income,

(c) any gain recognized for federal income tax purposes on the disposition of stock in a DISC, and any gain recognized on the disposition of stock in a former DISC, includible in gross income as a dividend pursuant to subsection (c) of section nine hundred ninety-five of the internal revenue code of nineteen hundred fifty-four, shall be treated as business income, and

(d) except as provided in paragraph (i) of subdivision nine of this section, any actual distribution from a DISC or a former DISC shall be treated as business income except an actual distribution which for federal income tax purposes is treated as made out of "other earnings and profits" under section nine hundred ninety-six of the internal revenue code of nineteen hundred fifty-four, in which case such actual distribution shall be treated as either subsidiary income or investment income under this article.

New York Tax Law § 208.9(a)(1)

9. The term "entire net income" means total net income from all sources, which shall be presumably the same as the entire taxable income which the taxpayer is required to report to the United States Treasury Department, or which the taxpayer would have been required to report, if it had not made an election under subchapter s of chapter one of the internal revenue code, except as hereinafter provided, and subject to any modification required by paragraph (d) of subdivision three of section two hundred ten of this article.

(a) entire net income shall not include:

(1) income, gains and losses from subsidiary capital which do not include the amount of a recovery in respect of any war loss except for such amounts from a former DISC which are treated as business income under subdivision eight-A of this section . . . .

New York Tax Law § 208.9(i)

(i) With respect to a DISC which during any taxable year or reporting year (1) received more than five percent of its gross sales from the sale of inventory or other property which it purchased from its stockholders, (2) received more than five percent of its gross rentals from the rental of property which it purchased or rented from its stockholders or (3) received more than five percent of its total receipts other than sales and rentals from its stockholders, the following provisions shall apply.

(A) For any taxable year in which sub-paragraph (B) of this paragraph is in effect and not rendered invalid, a DISC meeting the above test shall be exempt from all taxes imposed by this article.

(B) Supplemental to the provisions of subdivision five of section two hundred eleven of this article, any taxpayer required to compute a tax under this article, which during the taxable year being reported was a stockholder in any

DISC meeting the test prescribed in this paragraph, shall for any taxable year ending after December thirty-first, nineteen hundred seventy-one adjust each item of its receipts, expenses, assets and liabilities, as otherwise computed under this article, by adding thereto its attributable share of each such DISC's receipts, expenses, assets and liabilities as reportable by each such DISC to the United States Treasury Department for its annual reporting period ending during the current taxable year of such taxpayer; provided, however, (1) that all transactions between the taxpayer and each such DISC shall be eliminated from the taxpayer's adjusted receipts, expenses, assets and liabilities; (2) that the taxpayer's entire net income as otherwise computed under this section, shall be reduced by subtracting the amount of the deemed distribution of current income, if any, from each such DISC already included in the entire net income of such taxpayer by virtue of having been included in its entire taxable income for that taxable year as reported to the United States Treasury Department; and (3) that in the event this paragraph should be rendered invalid, all DISCs and their stockholders taxable hereunder shall be taxed instead under the remaining portions of this article.

New York Tax Law § 209.1

1. For the privilege of exercising its franchise or doing business in this state in a corporate or organized capacity for all or any part of each of its fiscal or calendar years . . . every domestic or foreign corporation, except corporations specified in subdivision four of this section, shall annually pay a franchise tax, upon the basis of its entire net income, or upon such other basis as may be applicable as hereinafter provided, . . . and [the tax] shall be paid as hereinafter provided.

New York Tax Law § 209.6

6. For any taxable year of a DISC, not exempt from tax under paragraph (i) of subdivision nine of section two hundred eight of this article, the taxes imposed by subdivision one of this

section shall be computed only under either clause two or clause four of paragraph (a) of subdivision one of section two hundred ten of this chapter, whichever is greater, and paragraph (b) of such subdivision.

New York Tax Law §§ 210.1-210.3

1. The tax imposed by subdivision one of section two hundred nine of this chapter shall be, in the case of each taxpayer:

(a) a tax (1) computed at the rate of nine per centum on its entire net income, or the portion thereof allocated within the state as hereinafter provided, subject to any modification required by paragraph (d) of subdivision three of this section, or (2) computed at one and six tenths mills for each dollar of its total business and investment capital, or the portion thereof allocated within the state as hereinafter provided, except that in the case of a cooperative housing corporation as defined in the internal revenue code or in the case of a housing company organized and operating pursuant to the provisions of article two of the private housing finance law, the applicable rate shall be four-tenths of a mill, or (3) computed at the rate of nine per centum on thirty per centum of the taxpayer's entire net income plus salaries and other compensation paid to the taxpayer's elected or appointed officers and to every stockholder owning in excess of five per centum of its issued capital stock minus fifteen thousand dollars (except as hereinafter provided) and any net loss for the reported year, or on the portion of such sum allocated within the state as hereinafter provided for the allocation of entire net income, subject to any modification required by paragraph (d) of subdivision three of this section, or (4) one hundred dollars, whichever is greatest, plus

(b) a tax computed at the rate of eight-tenths of a mill for each dollar of the portion of its subsidiary capital allocated within the state as hereinafter provided.

(c) In the case of a taxpayer which is not subject to tax for an entire year the exemption allowed in clause three

of paragraph (a) of this subdivision shall be prorated according to the period such taxpayer was subject to tax.

(d) If the taxable period for which the tax is due is less than an entire year, the minimum tax fixed by clause four of paragraph (a) of this subdivision shall be reduced by twenty-five per centum if the period for which such taxpayer is subject to tax is more than six months but not more than nine months and by fifty per centum if the period for which such taxpayer is subject to tax is not more than six months.

1-a. Notwithstanding any other provision of this chapter, an additional tax computed at the rate of five and three-quarters per centum on business income, or the portion thereof allocated within the state as hereinafter provided, is hereby imposed on every corporation subject to the tax imposed by this article which has gross receipts of five hundred thousand dollars or more for the taxable year from transportation, within this state, by omnibuses having a seating capacity of more than seven persons, other than receipts for the operation of school buses which are excluded from entire net income.

1-b. The computation specified in clause three of paragraph (a) of subdivision one shall not apply to a corporation organized under article fifteen of the business corporation law.

2. The amount of subsidiary capital, investment capital and business capital shall each be determined by taking the average fair market value of the gross assets included therein (less, in the case of business capital, average liabilities deductible therefrom which are payable by their terms on demand or within one year from the date incurred, other than loans or advances outstanding for more than a year as of any date during the year covered by the report, and, if the period covered by the report is other than a period of twelve calendar months, by multiplying such value by the number of calendar months or major parts thereof included in such period, and dividing the product thus obtained by twelve[ )].

3. The portion of the entire net income of a taxpayer to be allocated within the state shall be determined as follows:

(a) multiply its business income by a business allocation percentage to be determined by

(1) ascertaining the percentage which the average value of the taxpayer's real and tangible personal property within the state during the period covered by its report bears to the average value of all the taxpayer's real and tangible personal property wherever situated during such period;

(2) ascertaining the percentage which the receipts of the taxpayer, computed on the cash or accrual basis according to the method of accounting used in the computation of its entire net income, arising during such period from

(A) sales of its tangible personal property where shipments are made to points within this state,

(B) services performed within the state,

(C) rentals from property situated, and royalties from the use of patents or copyrights, within the state, and

(D) all other business receipts earned within the state, bear to the total amount of the taxpayer's receipts, similarly computed, arising during such period from all sales of its tangible personal property, services, rentals, royalties and all other business transactions, whether within or without the state;

(3) ascertaining the percentage of the total wages, salaries and other personal service compensation, similarly computed, during such period of employees within the state, except general executive officers, to the total wages, salaries and other personal service compensation, similarly computed, during such period of all the taxpayer's employees within and without the state, except general executive officers; and

(4) adding together the percentages so determined and dividing the result by the number of percentages; provided, however, that if the taxpayer does not have a regular place of business outside the state other than a statutory office, the business allocation percentage shall be one hundred percent;

Provided, however, that any taxpayer required to adjust its receipts, expenses, assets and liabilities by adding an attributable portion of the receipts, expenses, assets and liabilities of any DISC, as provided by paragraph (i) of subdivision nine of section two hundred eight of this article, shall substitute such adjusted figures in computing the percentages required in subparagraphs one, two and three of this paragraph.

(b) multiplying its investment income by an investment allocation percentage to be determined by

(1) multiplying the amount of its investment capital invested in each stock, bond or other security (other than governmental securities) during the period covered by its report by the percentage, if any, of the entire capital or the issued capital stock, or the gross direct premiums, or the net income, as the case may be, of the issuer or obligor thereof required to be allocated within the state on the report or reports, if any, required of any such issuer or obligor under this chapter or the insurance law for the preceding year, but without regard to any minimum,

(2) adding together the sums so obtained, and

(3) dividing the result so obtained by the total of its investment capital invested during such period in stocks, bonds and other securities (other than obligations of the United States and its instrumentalities and obligations of the state of New York, its political subdivisions and its instrumentalities); provided, however, that in case any investment capital is invested in any stock, bond or other security during only a portion of the period covered by the report, only such portion of such capital shall be taken into account; and provided further, that if a taxpayer's investment allocation percentage is zero, interest received on

bank accounts, on obligations of the United States and its instrumentalities and on obligations of the state of New York, its political subdivisions and its instrumentalities shall be multiplied by its business allocation percentage; provided, however, that with respect to corporations organized under article fifteen of the business corporation law, the investment allocation percentage shall be one hundred percent; and

(c) add the products so obtained.

(d) At the election of the taxpayer there shall be deducted from the portion of its entire net income allocated within the state either or both of the items set forth in subparagraphs one and two of this paragraph, except that only one of such deductions shall be allowed with respect to any one item of property.

New York Tax Law § 210.13

13. (a) So long as the taxation procedures relating to a DISC provided in subparagraph (B) of paragraph (i) of subdivision nine of section two hundred eight of this article are in effect and not rendered invalid any taxpayer which during the taxable year being reported was a stockholder in any such DISC shall be allowed a DISC export credit, to be computed as hereinafter provided, against the tax imposed by this article after allowance of any credit permitted under subdivision eleven and subdivision twelve of this section. The amount of the credit shall be computed separately for each such DISC, based upon its operations during its annual reporting period ending the current taxable year of such stockholder, as follows:

(1) ascertaining the amount, if any, of such taxpayer's attributable share of the total current earnings and profits earned by such DISC for the reporting year which were included in its accumulated DISC income account pursuant to subsection (a) of section nine hundred ninety-six of the internal revenue code of nineteen hundred fifty-four,

(2) ascertaining a percentage by (i) totaling the gross receipts from the sale, lease, rental or other disposition of export property (as defined under subsection (c) of section nine hundred ninety-three of the internal revenue code of

nineteen hundred fifty-four) of the taxpayer by or to such DISC, and (ii) totaling such gross receipts from such export property of the taxpayer shipped from a regular place of business of the taxpayer within this state by or to such DISC and then (iii) dividing the total developed in (ii) above by that developed in (i) above (provided, however, for the purposes of this subparagraph, the tax commission may require such gross receipts to be computed on a similar basis for all such export property to properly reflect the percentage of such gross receipts attributable to export property shipped from a regular place of business of the taxpayer within this state),

(3) multiplying the amount ascertained in subparagraph one of this paragraph by the percentage ascertained in subparagraph two of this paragraph,

(4) ascertaining the amount of the taxpayer's taxable income as determined in subparagraphs one, two and three of this paragraph that is eligible for credit by multiplying the product ascertained in the preceding subparagraph by the taxpayer's business allocation percentage determined as provided in paragraph (a) of subdivision three of this section,

(5) the amount of DISC export credit attributable to the operations of each such DISC is then found by multiplying seventy percent of the taxpayer's taxable income that is eligible for credit, as computed in the preceding subparagraph, by the rate of tax applying to the taxpayer, as provided in subdivision one of this section,

(6) the taxpayer's total DISC export credit is the sum of the DISC export credits attributable to each DISC that qualifies for tax exemption under paragraph (i) of subdivision nine of section two hundred eight of this article, in which it was a stockholder during the taxable year being reported.

(b) The credit allowed under this subdivision for any taxable year shall not reduce the tax due for such year to less

than one hundred twenty-five dollars; nor may any unused credit be carried over to any following year.

New York Tax Law § 211.1

1. Every taxpayer, as well as every foreign corporation having an officer, agent or representative within the state, shall annually on or before March fifteenth transmit to the tax commission a report in a form prescribed by it (except that a corporation which reports on the basis of a fiscal year shall transmit its report within two and one-half months after the close of its fiscal year and except, also, that a corporation which is a DISC shall transmit its report on or before the fifteenth day of the ninth month following the close of its calendar or fiscal year), setting forth such information as the tax commission may prescribe and every taxpayer which ceases to exercise its franchise or to be subject to the tax imposed by this article shall transmit to the tax commission a report on the date of such cessation or at such other time as the tax commission may require covering each year or period for which no report was theretofore filed. Every taxpayer shall also transmit such other reports and such facts and information as the tax commission may require in the administration of this article. The tax commission may grant a reasonable extension of time for filing reports whenever good cause exists.

An automatic extension of three months for the filing of its annual report shall be allowed any taxpayer if, within the time prescribed by the preceding paragraph, such taxpayer files with the tax commission an application for extension in such form as said commission may prescribe by regulation and pays on or before the date of such filing the amount properly estimated as its tax.

New York Tax Law § 211.4

4. In the discretion of the tax commission, any taxpayer, which owns or controls either directly or indirectly substantially all the capital stock of one or more corporations, or substanially

all the capital stock of which is owned or controlled either directly or indirectly by one or more other corporations or by interests which own or control either directly or indirectly substantially all the capital stock of one or more other corporations, may be required or permitted to make a report on a combined basis covering any such other corporations and setting forth such information as the tax commission may require; provided, however, that any corporation which owns or controls either directly or indirectly substantially all the capital stock of a DISC not exempt from tax under paragraph (i) of subdivision nine of section two hundred eight of this article shall be allowed, at the election of such corporation, to make a report on a combined basis covering such DISC, but the failure of such corporation to make such election shall not prohibit the tax commission from requiring a combined report covering such corporation and such DISC; provided, further, that no combined report covering any corporation not a taxpayer shall be required unless the tax commission deems such a report necessary, because of inter-company transactions or some agreement, understanding, arrangement or transaction referred to in subdivision five of this section, in order properly to reflect the tax liability under this article. In the case of a combined report the tax shall be measured by the combined entire net income or combined capital, of all the corporations included in the report. In computing combined entire net income intercorporate dividends shall be eliminated, in computing combined business and investment capital intercorporate stockholdings and intercorporate bills, notes and accounts receivable and payable and other intercorporate indebtedness shall be eliminated and in computing combined subsidiary capital intercorporate stockholdings shall be eliminated, provided, however, that intercorporate dividends from a DISC or a former DISC not exempt from tax under paragraph (i) of subdivision nine of section two hundred eight of this article which are taxable as business income under this article shall not be eliminated.

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No. 81-2391

IN THE

Supreme Court of the United States

October Term, 1982

WESTINGHOUSE ELECTRIC CORPORATION,
Appellant,

against

JAMES H. TULLY, JR., *et al.*, as the Tax Commission of the State of New York,
Appellees.

ON APPEAL FROM THE COURT OF APPEALS OF THE STATE OF NEW YORK

BRIEF OF APPELLEES

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Dated: July 14, 1983

Question Presented.

Whether the New York Tax Law violates the Commerce Clause of the United States Constitution and the Equal Protection Clause of the Fourteenth Amendment to the United States Constitution insofar as it provides for a credit against corporate franchise tax liability of corporate shareholders of domestic international sales corporations (DISCs), where the credit is computed only with respect to the New York income of DISCs attributable to shipments of export property from regular places of business of the corporate shareholders in New York.

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No. 81-2394

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1982

WESTINGHOUSE ELECTRIC CORPORATION,

Appellant,

against

JAMES H. TULLY, Jr., *et al.*, AS THE TAX COMMISSION OF THE STATE OF NEW YORK,

Appellees.

ON APPEAL FROM THE COURT OF APPEALS OF THE STATE OF NEW YORK

BRIEF OF APPELLEES

Decisions Below

The opinion of the Court of Appeals of the State of New York is reported at 55 NY2d 364, 434 NE2d 1044 and 449 NYS2d 677, and is reprinted in the Joint Appendix ("JA") at pages 57-66. The opinion of the Appellate Division, Supreme Court of the State of New York, Third

Judicial Department, is reported at 82 AD2d 988 and 440 NYS2d 397, and is reprinted at JA, pp 50-54. An unpublished order of the Appellate Division, dated June 29, 1981, appears at JA, pp 55-56. The unpublished order of the Supreme Court of the State of New York, Albany County, transferring the proceedings to the Appellate Division, dated January 25, 1980, appears at JA, pp 48-49. The unpublished decision of the New York State Tax Commission, dated August 31, 1979, appears at JA, pp 41-47.

Jurisdictional Basis of Appeal

This is a limited appeal from a judgment of the Court of Appeals of the State of New York which upheld the provision of New York Tax Law, Article 9-A, Franchise Tax on Business Corporations, which imposes a tax on corporations measured by New York allocated entire net income including the income of a DISC of which the taxpayer is a shareholder and provides for some credit against that tax with respect to income from the sale of export property included therein. This Court in noting probable jurisdiction on January 17, 1983, limited it to question 1 presented by the jurisdictional statement as follows:

> "Whether the grant by New York State of a large credit against the franchise tax payable by the corporate parent of a domestic international sales corporation ('DISC') *only* with respect to income attributable to shipments made from New York violates the Commerce Clause of the United States Constitution and the Equal Protection Clause of the Fourteenth Amendment to the United States Constitution?"

Constitutional, Statutory Provisions and New York Tax Regulations

The pertinent text of the constitutional and statutory provisions involved in this case appears in the appendix to this brief as indicated:

Article I, §8, clause 3 (Commerce Clause) of the United States Constitution appears at page A-1.

Amendment XIV, § 1 of the United States Constitution appears at page A-1.

New York Tax Law, Article 9-A, §§ 208.1, 208.8, 208.8-A, 208.9(a), 208.9(i), 209.1, 209.6, 210.1-210.3, 210.13, 211.1 and 211.4 (McKinney 1966 and 1974 Supp), the provisions governing the State franchise tax on DISCs as in effect during the relevant years, appear at pages A-1 - A-13.

New York State Commission Regulations, §§ 5-4.1 - 5-4.3, although not in effect for the years involved, conform to the pertinent provisions of the Tax Law for the relevant years, appear at pages A-14 and A-15.

Statement of the Case

A. Federal and New York taxation of corporations which are shareholders of domestic and international sales corporations.

Under the Internal Revenue Code of 1954, §§ 991-997 (Public Law 92-178) for taxable years beginning after 1971, a domestic sales corporation whose income is predominantly (95%) derived from export sales and rentals may defer paying United States tax up to 50% of that

income. The other half is taxed directly to shareholders even though it is not distributed to the shareholders, but under the law is "deemed" distributed to them. Such distributions are deemed part of such shareholders' Federal taxable income. A corporation entitled to this treatment is referred to as a "Domestic International Sales Corporation" (DISC). The tax-deferred income (accumulated income) is never taxed to the DISC. Such income is taxed to the shareholders only when distributed, when a shareholder sells his stock, or when the corporation no longer qualified as a DISC. The 50% of the DISC's income that is taxed directly to shareholders, certain other constructive distributions, and actual distributions to shareholders are treated as dividends (but, in the case of actual distributions, only to the extent that they exceed income previously taxed directly to shareholders). A DISC may not join in filing a Federal consolidated return. Under the intercompany pricing rules of the Federal law, a DISC may earn profits although in excess of profit it would earn in an arm's length transaction and regardless of the sales price actually charged on products which it purchases from a related company and then resells for export. IRC, § 994.

New York does not tax a DISC, such as Westinghouse Electric Export Corporation, which, during a taxable year, received more than 5% of its gross receipts from the sale or rental of property of its shareholders.

When a corporate taxpayer subject to franchise taxes under Article 9-A of the New York Tax Law is a shareholder of an exempt DISC, the corporate taxpayer must file its own tax report and a consolidated report with the DISC. The consolidated report must contain the attributable share (based on percentage of stock ownership)

of the receipts, expenses, assets and liabilities of the DISC as well as the property, receipts and wages of the DISC eligible for use in the computation of the business allocation percentage. The corporate taxpayer must adjust its receipts, expenses, assets and liabilities to include its attributable share of the DISC's receipts, expenses, assets and liabilities; eliminate any deemed or actual distributions received from the DISC to the extent already included in entire net income; and eliminate intercorporate transactions between the corporate taxpayer and the tax exempt DISC (McKinney's New York Tax Law, §§ 208 [9] [i], 210[3] [a]).

New York State allows a shareholder of exempt DISCs a DISC export credit, computed separately for each DISC, after allowance of various credits such as for an eligible busines facility and the credit for investment in production facilities. The credit is computed by multiplying the shareholder's share of accumulated DISC income by the ratio of gross receipts received from the sale of export property sold by the DISC shipped from a regular place of business of the shareholder in New York over the total gross receipts from the sale of export property sold by the DISC, then multiplying that product by the shareholder's New York business allocation percentage, multiplied by 70%, and multiplied by the shareholder's rate of New York tax (9% in the years under review, 1972 and 1973).

B. Factual Statement.

As stipulated and found by the New York State Tax Commission, the appellant, Westinghouse Electric Corporation (Westinghouse), is a Pennsylvania Corporation which does business in New York. It is engaged in the

manufacture and sale of electric equipment, parts and appliances. Westinghouse owns all the stock of Westinghouse Electric Export Corporation (Westinghouse DISC), a Delaware corporation, which elected to be treated as a domestic international sales corporation for Federal income tax purposes and was so treated for the years 1972 and 1973. It qualified as a DISC under IRC, § 992(a) and was exempt from Federal income tax for such years under IRC, § 991 (JA, p 42).

Westinghouse DISC was a commission agent for Westinghouse and its affiliated companies in respect of export sales of property and related services. All of Westinghouse's DISC's business income for 1972 and 1973 consisted of commissions paid it for such sales for those companies. Westinghouse's DISC had no employees, did not engage in any business activities in New York and did not employ capital, own or lease real or tangible personal property, pay real estate rentals or maintain an office in New York State at any time during such years (JA, pp 42, 43). (It appears that Westinghouse's DISC had no employees of its own and did not own any real or tangible personal property, or pay real estate rentals anywhere [JA, p 9].)

The DISC's sources of income for 1972 and 1973 are as follows (JA, p 43):

Sources of Income	1972	1973
From Westinghouse	$19,888,000	$47,180,132
From affiliated companies of Westinghouse	6,099,000	10,768,606
TOTALS	$25,987,000	$57,948,738

The affiliated companies did not do business in New York State.

Under the provisions of IRC, § 995(b), of these amounts $12,956,500 for 1972 and $29,838,006 for 1973 was deemed distributed to Westinghouse during those years. Westinghouse accordingly included those amounts in its Federal gross income for those years. Federal taxation of the remainder of Westinghouse DISC's income for those years was deferred under the provisions of the Internal Revenue Code (JA, p 43).

Westinghouse DISC made no distribution of income in 1972, but in 1973 it distributed $10,068,500 to Westinghouse. For Federal purposes, this distribution was treated as made out of previously taxed income under IRC, § 996(a) (1) (JA, p 43).

Westinghouse filed New York State corporation franchise tax returns for these years in which it reported entire net income of $136,516,711 for 1972 and $43,715,850 for 1973. These amounts included the $12,956,500 and $29,838,006 deemed distribution of income from Westinghouse DISC for those respective years. The reported income did not include any portion of Westinghouse DISC's accumulated income which was deferred for tax purposes under Federal law.

On the New York State returns, Westinghouse's reported entire net income was allocated to New York State under "business allocation percentages of 6.387743% for 1972 and 6.239516% for 1973 computed without regard to such deemed distributions" by Westinghouse DISC. Westinghouse paid New York State franchise taxes in the amount of $749,384 for 1972 and $205,548 for 1973 (JA, pp 43, 44, 46).

After an audit of Westinghouse, notices of deficiency were issued for the years in the amount of $73,970.23 plus interest for 1972 and $151,436.76 plus interest for 1973. An error was made in the calculation of the deficiency for 1972 because of a transposition of a number. The deficiency of tax, if the error had not been made, should be $71,970 for that year (JA, pp 44, 46).

The notices of deficiency of tax were computed by the New York State Tax Commission on the following basis:

(a) Because more than 5% of Westinghouse DISC's gross receipts in both 1972 and 1973 consisted of sales commissions from Westinghouse, Westinghouse DISC is exempt from New York State franchise tax under section 208(9) (i) (A) of the New York Tax Law, whether or not New York State otherwise had jurisdiction to subject it to tax. Westinghouse is required under section 208(9) (i) (B) of the New York Tax Law to consolidate Westinghouse DISC's receipts, expenses, assets and liabilities with its own in computing its New York State income tax liability, excluding all transactions between Westinghouse and Westinghouse DISC. Since Westinghouse included only the deemed distributions from Westinghouse DISC for 1972 and 1973, and not all Westinghouse DISC's income for such years in its own entire net income for 1972 and 1973, Westinghouse's entire net income for 1972 was increased by $13,390,500 (correct amount should be $13,030,500) from $136,516,711 to $149,907,211 and its entire net income for 1973 was increased by $28,110,732 from $43,715,850 to $71,826,582 (JA, pp 43, 44);

(b) The receipts factors used to compute Westinghouse's business allocation percentages for 1972 and 1973 were recomputed by adding Westinghouse DISC's commission

income derived for such years from customers other than Westinghouse (which other customers did not do business in New York State and were not subject to New York tax) to the denominator of such factors, but not to the numerator, thus reducing Westinghouse's receipts factor for 1972 from 5.945712% as reported on its 1972 return to 5.935845% and reducing its receipts factor for 1973 from 5.665182%, as reported on its 1973 return, to 5.650114%. Such a calculation results in a reduction of Westinghouse's business allocation percentage for 1972 from 6.387743% to 6.384454% and for 1973 from 6.239516% to 6.234494%. The net effect of the two adjustments for 1972 described above increased Westinghouse's business income for 1972 allocable to New York State from $8,683,334 to $9,533,778, an increase of $850,444, with a resulting deficiency in tax for 1972 of $76,539.96. Similarly, the net effect of the adjustments for 1973 described above increased Westinghouse's business income for 1973 allocable to New York State from $2,702,912 to $4,453,304, an increase of $1,750,392, with a resulting deficiency in tax for 1973 of $157,535.28 (JA, pp 44, 45);

(c) Westinghouse was allowed credits under section 210(13) (a) of the Tax Law in the respective amounts of $2,569.77 and $6,098.22 for 1972 and 1973. Such credits were computed by first multiplying $13,390,500 and $28,110,732, representing accumulated Westinghouse DISC income for 1972 and 1973 respectively, as computed by the auditor, by 4.771297% and 5.523182%, respectively. Those percentages are the percentages of Westinghouse's receipts from export property on which Westinghouse DISC earned a sales commission and which were shipped from a regular place of business of Westinghouse in New York as compared to Westinghouse's total receipts on the sale of export property for such years for which

Westinghouse DISC received a sales commission. Such total receipts amounted to $223,587,000 in 1972 and $408,080,000 in 1973 (JA, pp 45, 46).

The respective products, $638,091 for 1972 and $1,552,607 for 1973, were then multiplied by Westinghouse's revised business allocation percentages for the respective years, with the result that of the $13,390,500 and $28,110,732 includable in Westinghouse's entire net income for 1972 and 1973, respectively, only $40,790 and $96,797 respectively, were found to be eligible for credit under section 210(13) (a). These amounts were then multiplied first by 70% and then by the 9% rate of tax in effect for 1972 and 1973 to arrive at credits of $2,569.77 and $6,098.22 for 1972 and 1973, respectively (JA, p 46).

C. Proceedings Below.

Westinghouse filed a petition for a redetermination of the notices of deficiency issued for 1972 and 1973. In the petition it contended that by requiring Westinghouse to compute its franchise tax liability by combining its receipts and expenses with those of Westinghouse DISC, thereby taxing accumulated DISC income and deemed distributed income of Westinghouse DISC, appellees violated the Commerce Clause of the United States Constitution and the Due Process and Equal Protection Clauses of the Fourteenth Amendment. Westinghouse also contended that limiting the export credit to income attributable to shipments made from a regular place of business in New York State violated the Commerce Clause and the Equal Protection Clause. The State Tax Commission's determination denied Westinghouse's petition (JA, pp 41-47).

Westinghouse brought a proceeding in the New York Supreme Court for judicial review of the State Tax Commission's determination in which it again raised its constitutional claims. The proceeding was transferred to the Appellate Division, Third Department, for disposition (JA, pp 48, 49).

The Appellate Division, two Justices dissenting, held that New York Tax Law, § 208(9) (i) (B), to the extent it requires Westinghouse DISC's accumulated income be added to Westinghouse's income, is unconstitutional on the ground that it settles an impermissible burden on foreign commerce (JA, pp 50-54).

The State Tax Commission appealed from that portion of the Appellate Division's decision that invalidated section 208(9) (i) (B), and Westinghouse cross-appealed to the extent that the Appellate Division had upheld the tax on deemed distributions. Westinghouse raised the consitutional claims that it had presented before the State Tax Commission and the Appellate Division, and which it claims before this Court. The Court of Appeals rejected Westinghouse's constitutional claims and upheld the franchise tax in all respects (JA, pp 57-66). Its order modified the order of the Appellate Division and reinstated the determination of the State Tax Commission (JA, p 67).

The New York Court of Appeals, in discussing the export tax credit, said:

> "Here the record shows that Westinghouse and its DISC were operating a unitary business. Not all the accumulated DISC income was subjected to taxation, but rather only that part allocable to New York (Tax Law, §§ 208.9[i] [B], 210.1[a], 210.3; *cf.*

Fischbach & Moore v. Tax Comm., 36 N.Y.2d 605, 607). Moreover, there is nothing in the record to show that the income was improperly apportioned to business done in New York; nor does the taxpayer question our State's allocation formula.

* * *

"[Westinghouse] reasons that the effect of the credit is impermissibly to subject its export sales from a non-New York 'place of business' to a higher rate of tax than comparable sales 'shipped from a regular place of business' within New York.

* * *

"The first step to be taken to arrive at the amount of such tax credit is to multiply the taxpayer's share of the accumulated DISC income by the taxpayer's New York 'business allocation percentage' (Tax Law, § 210.3). This yields the dollar value of the accumulated DISC income allocable to New York as *instate* earnings. This amount is then multiplied by that percentage which the taxpayer's receipts from export property on which the DISC earned commissions *and* which was shipped from a regular place of business in New York bears to the taxpayer's total receipts from the sale of export property on which the DISC earned commissions. The product of this calculation is the amount eligible for the credit; it is merely a subdivision of the accumulated DISC income allocable to New York.

"Obviously, the business allocation percentage plays an integral role in computing the tax credit. It

determines what amount of the taxpayer's income has a jurisdictional nexus with the State. The result is that, when the State exercises its taxing power, it does so consistently with due process mandates [citations omitted].

"But New York need not tax all which it has the right to tax. The credit here simply forgives a portion of that income which New York may tax by reference to shipments of export property from a regular place of business in New York, an additional New York relationship. Such a method clearly satisfies due process, and any effect on interstate commerce is too indirect to run afoul of the commerce clause." (JA pp 63-65).

Summary of Argument

Contrary to the assertions of Westinghoue, New York taxes only income reasonably allocated to it. In order to subject New York DISC income to New York franchise taxes, New York requires that the corporate shareholder consolidate its income with its share of DISC income. An allocation of all that income is then made to New York. The New York franchise tax is imposed on the corporate shareholder solely on the income allocated to New York.

A tax credit, which is now the only subject of this appeal, is allowed against this tax. A credit is determined based upon the percentage of receipts which is derived from the shipment of export property from a regular place of business of the taxpayer in New York. The effect of the credit does not place a higher tax on the taxpayer on its export sales from a non-New York place of business but merely lessens the tax on its New York income resulting from shipments of export property from a New York regular place of business of the taxpayer. Such income is

taxed because it is earned in this State. Income from non-New York business is not taxed by New York and accordingly no credit is given for business income which is not derived from New York sources.

The credit is given to enable New York to compete with other States. States are free to use their taxing power "to encourage the growth and development of intrastate commerce and industry * * * [and to] compete with other States for a share of interstate commerce; such competition lies at the heart of a free trade policy" (*Boston Stock Exchange v. State Tax Comm.*, 429 US 318, 336-337 [1977]). That this is what the credit allowed by section 210.13(a) accomplishes, and no more, is demonstrated by an analysis of how it is calculated. Experience demonstrates that the export tax credit has not resulted in an increase in New York's export business. Its percentage of such business has been declining since 1972. There is no way to demonstrate by the record that New York's export business has been affected by the credit.

ARGUMENT

The tax credit against New York franchise taxes does not discriminate against or burden interstate commerce in reducing New York taxes on income allocated to New York by limiting the computation of the credit to shipments of export property from a regular place of business of corporate shareholders in New York.

Westinghouse contends (Br, p 21) that New York imposes franchise taxes on the income of a corporate shareholder of a tax exempt DISC which derives from sales shipped from facilities outside of New York and sales of affiliates of the corporate shareholder which affiliates do

not transact business in New York. These claims are wrong factually. New York only taxes income reasonably allocated to New York. Coupled with these falsely premised contentions, appellant argues (Br, p 23) that the New York tax credit, which is limited in its application to shipments from facilities in New York, violates the Commerce Clause of the United States Constitution and the Due Process and Equal Protection Clauses of the Fourteenth Amendment to the United States Constitution. This argument has no substance.

Westinghouse premises its argument on its assertions (Br, p 4) that New York imposes its franchise tax on the income of a DISC (deemed distributions, actual distributions, and accumulated income) "with respect to sales having no relation to New York by *including* in its computation of the DISC's income revenues derived from sales of affiliates not doing business in New York, while *excluding* the receipts, property and payroll of those affiliates from its apportioned calculations". These claims are contrary to fact and are not supported by the record. The only DISC income subject to New York tax is that part allocable to New York. (See opinion of the Court of Appeals below [JA, p 63].) Indeed, in making these assertions, appellant attempts to present issues included in question 2 of its jurisdictional statement which this Court refused to entertain. Question 1 of the jurisdictional statement, the only question before this Court, makes no reference to a Due Process issue. Additionally, Westinghouse has misstated (Br, p 17) the limitation placed on the application of the tax credit in alleging that export shipments are only required to be made from New York. The tax credit is limited to shipments of export property from a regular place of business in New York of the corporate shareholder.

It is undisputed that Westinghouse and Westinghouse DISC are engaged in a unitary business. This fact is no longer in issue in this case in view of this Court's refusal to consider Question 2. Thus, it is appropriate to require the two corporations to file a consolidated New York franchise tax return. However, in view of appellant's fundamental misstatements, a brief summary seems desirable to point out that New York is taxing only New York income. The DISC is a wholly owned subsidiary of Westinghouse and approximately 80% of the DISC income is derived from commissions received from Westinghouse. Westinghouse DISC apparently had no employees of its own and did not own any real or tangible personal property or pay real estate rentals anywhere. In this context, combining Westinghouse and Westinghouse DISC income prior to apportionment, is fully justified. See *Container Corporation of America v. Franchise Tax Board*, ____ US ____ (1983); *Mobil Oil v. Commissioner of Taxes*, 445 US 425 (1980); *Exxon Corp. v. Wisconsin Department of Revenue*, 447 US 207 (1980); *F. W. Woolworth v. Taxation and Revenue Dept*, 458 US ____ (1982); *Asarco, Inc. v. Idaho State Tax Commission*, 458 US ____ (1982).

Indeed, New York has long required or permitted affiliated companies to file franchise tax returns in which their income is combined where they have substantial intercompany transactions. See *Wurlitzer v. State Tax Commission*, 35 NY2d 100 (1974), 316 NE2d 301, 358 NYS2d 1.

As this Court has recognized, Westinghouse simply failed to demonstrate that the New York Tax Law, by requiring Westinghouse and its DISC to consolidate their income, reaches DISC income derived from affiliates of

Westinghouse which do not do business in New York and which are not engaged in a unitary business with Westinghouse. The entire consolidated net income of Westinghouse and Westinghouse DISC is allocated to New York, by the use of a three-factor formula using the factors of property, wages and receipts within and without New York weighted equally to arrive at a business allocation percentage. This percentage is applied to a taxpayer's entire consolidated net income to arrive at a base on which the tax rate (9%) is applied prior to the application of the tax credit. (The formula's provisons are set out in New York Tax Law, § 210[3].)

Thus, not all of the DISC income is subject to New York taxation. Only the New York portion of the entire consolidated net income of Westinghouse and Westinghouse DISC is taxed.

It is settled that the "entire net income of a corporation, generated by interstate as well as intrastate activities, may be fairly apportioned among the States for tax purposes by formulas utilizing in-state aspects of interstate affairs." *Northwestern States Portland Cement Co. v. Minnesota*, 358 US 450, 460 (1959); *General Motors Corp. v. Washington*, 377 US 436 (1964); *Complete Auto Transit v. Brady*, 430 US 274 (1977); *Mobil Oil Corp. v. Commissioner of Taxes*, 445 US 425, 436-442 (1980). In determining what constitutes "fairly apportioned", this Court has enunciated the following standard:

> 'That the apportionment may not result in mathematical exactitude is certainly not a constitutional defect. Rough approximation rather than precision is, as a practical matter, the norm in any such tax system." *Illinois Central Railroad Co. v.*

State of Minnesota, 309 US 157, 161 (1940), reh den, 309 US 695 (1940).

Westinghouse has not claimed that the application of the New York three-factor allocation formula to its income results in New York taxing income which the State does not have jurisdiction to tax. Indeed, if it had demonstrated in the proceedings below that income of Westinghouse was being improperly allocated to New York by the formula, the New York State Tax Commission could have exercised its authority under New York Tax Law, § 211(5) to adjust the formula so as to equitably determine its New York tax. Aside from being foreclosed by this Court's order in taking jurisdiction of this appeal, Westinghouse's failure to demonstrate that the New York allocation formula reaches income which does not have a nexus in New York forecloses it from now claiming that New York taxes such income.

Much of the appellant's brief is based on the absurd premise that the three-factor formula applied to apportion the income of the corporations in the unitary business (i.e., Westinghouse and Westinghouse DISC) must include the receipts, payroll and property of the customers of the DISC which are not components of the unitary business. Clearly, neither the principles of fair apportionment announced by this Court (nor any statement or holding by this Court) provide any support for this totally erroneous argument concerning apportionment. The instant case is one where fair apportionment is clearly shown because the receipts, payroll and property of Westinghouse and the receipts of Westinghouse DISC are the basis for the three-factor formula apportionment which is applied to the consolidated income of Westinghouse and Westinghouse DISC. As we have already indicated earlier in this brief,

Westinghouse DISC apparently had no employees of its own, did not own real property or tangible personal property or lease real property from others (JA, p 9).

The credit is allowed against the New York tax which is measured by New York income, but only to the extent the commission income also has a New York connection. The burden to show discrimination against interstate commerce rests on the party challenging the statute. *Hughes v. Oklahoma,* 431 US 322, 336 (1979). Contrary to appellant's position, there is no conceivable basis why New York should give a credit for commission (DISC) income that it never taxed in the first instance. As such the tax credit does not discriminate against interstate commerce. The tax and the credit do not affect interstate commerce in any greater degree than any other state tax or credit on business income.

States are not prevented from structuring their tax systems to encourage growth, industry, and interstate commerce. States may compete with other States for a share of interstate commerce although they may not discriminatorily tax products manufactured or the business operations performed in any other State. See, *Boston Stock Exchange v. State Tax Commission,* 429 US 318, 336-337 (1977). It has not been suggested by this Court that States cannot structure their tax systems to compete with other States for a share of foreign commerce. Indeed, such competition between States promotes the Federal goal of increasing exports. States, moreover, have the power to impose a heavier tax burden on one class of taxpayers or income within their borders than on another provided all persons and property in the same class are treated alike. It is well established, of course, that States have broad discretion on classifying corporations

for tax purposes and impose varying taxes on separate classifications. See, e.g., *Walters v. City of St. Louis*, 347 US 231, 237-238 (1954); *Ohio River & W. R. Co. v. Ditty*, 232 US 576 (1914); *People ex rel. Hatch v. Reardon*, 184 NY 431 (1906), affd 204 US 152 (1907); *Metropolitan Street R. Co. v. New York State Board of Tax Comrs.*, 199 US 1 (1904); *Pacific Exp. Co. v. Seibert*, 142 US 339 (1892).

Appellant's reliance (Br, pp 16-17) on *Boston Stock Exchange* is totally misplaced. There, in taxing the sale of securities that would be delivered or transferred in New York, a higher rate of tax applied if the securities were sold by a non-resident through an out-of-state exchange. Moreover, if New York's residents made a large block transaction on a New York exchange, the tax was substantially less than if made through an out-of-state exchange. These extra tax burdens imposed for using out-of-stock exchanges were held to fall short of the substantially evenhanded treatment demanded by the Commerce Clause. But this Court also stated (429 US at 337) that we "hold only that in the process of competition no State may discriminatorily tax the products manufactured or the business operations performed in any other State". Here, of course, New York has taken care not to tax out-of-state income and has simply chosen to tax that part of the taxpayer's New York income stemming from exports (New York related exports since only New York income is being taxed) at a lesser rate than non-export New York income.

Appellant's reliance (Br, pp 16-12) on *Maryland v. Louisiana*, 451 US 725, 754 (1981), is also misplaced. There Louisiana imposed a so-called first use tax on natural gas from the outer-continental shelf, which concededly was to be passed on to consumers of that gas in

much of the country. However, by use of a number of credits and exemptions, Lousiana consumers of gas were to be largely immune from the tax. This tax was also struck down for not treating interstate commerce in an evenhanded manner with intrastate commerce. The case has no relation to the situation here where only income properly allocated to New York is being taxed at all and hence entitled to a credit.

We recognize, of course, that this Court has viewed with suspicion state statutes requiring business operations to be performed in the home State that could be more efficiently performed elsewhere. See *Pike v. Bruce Church, Inc.*, 397 US 137, 145 (1970), which involved a statute which prevented the interstate bulk shipment of cantaloupes grown in Arizona. The statute had the effect of compelling the producer to build unneeded packing facilities in Arizona. This Court held the Commerce Clause does not permit a State to require work to be done within its jurisdiction to enhance the reputation of other producers within its borders.

The New York tax credit does not require business operations to be performed in New York nor does it provide a significant inducement to corporations to conduct export business from a place of business in New York. The small inducement which the credit provides in reality has the same effect as taxing New York income from export business at a lower rate than the same business activities would be taxed if they were not conducted for export. In other words, the tax credit results in a lower effective tax rate. This right of New York to structure its tax scheme to encourage commerce was explicitly recognized in *Boston Stock Exchange, supra*. If the credit is viewed as an indirect subsidy to export commerce, it does not discriminate against interstate commerce. All States give indirect subsidies to commerce in financing facilities such as

ports, airports, waterways and highways, providing job incentive and investment tax credits as well as providing police and fire protection.

Moreover, while we belive a tax credit to encourage local business is appropriate, the Court should recognize that the actual application of the provision here is resulting in very slight credit. (We observe that appellant's underlying position that DISC income should not be taxed at all would result in a larger benefit.)

A "state tax must be assessed in light of its actual effect considered in conjunction with other provisions of the State's tax scheme". *Maryland v. Lousiana,* 451 US 725, 756 (1981); *Complete Auto Transit v. Brady,* 430 US 274 (1977). The practical operation of the tax credit does not discriminate against interstate commerce.

Under Federal law, corporations which are shareholders of DISCs are taxed differently from corporations which are shareholders of corporations which are not DISCs. DISCs are not taxpayers. Shareholders of DISCs are taxed on DISC income for a year in which it is earned or for a year to which DISC income is deferred. Transactions between shareholders of a DISC and a DISC are not limited to arms-length pricing but are permitted to use special pricing arrangements. IRC, §994. The special pricing rules permit the transfer of income from a shareholder corporation to its non-taxed DISCs.

This Federal tax scheme would result in New York income of both the corporate shareholder and its DISC escaping New York franchise taxes unless special provisions were made for their taxation. The New York law prevents New York income of a parent and its DISC from

escaping New York taxes by requiring the corporate shareholders of a tax exempt DISC (taxpayer) and its DISC to consolidate their income. The tax credit does not, as we have seen, result in a benefit being given local business at the expense of out-of-state commerce.

The DISC tax credit is determined separately for each DISC, after allowance of any other credit given for an eligible business facility, certain compensatory use taxes, investment, and employment incentives. If these credits reduce a DISC shareholder's tax below a minimum tax ($125 for the years 1972 and 1973), the tax credit would not be available. New York Tax Law, § 210(13)(a).

The tax credit is computed by multiplying the DISC shareholder's share of DISC accumulated income by the percentage of the gross receipts from sales made by the DISC of export property of the taxpayer (Westinghouse) shipped from the regular place of business of taxpayer within New York by or to the DISC divided by the total receipts from the sale of export property made by or to the DISC. The product is then multiplied by the taxpayer's New York business allocation percentage. The resulting product is then multiplied by 70%, the product of which is then multiplied by the taxpayer's tax rate. The result is the amount of the export tax credit. (New York Tax Law, § 210[13][a]).

Accumulated income is defined by Internal Revenue Code § 996 and in general means total income less actual and deemed distributions. Accumulated income cannot exceed 50% of DISC income.

Under the New York law, "export property" for purpose of the credit is defined by IRC, § 993, subd (c).* To qualify for the credit, the export property must be shipped from "a regular place of business" of the taxpayer within the State. A regular place of business is defined as "any bona fide office (other than a statutory office), factory, warehouse or other space which is regularly used by the taxpayer in carrying on its business". The term "regular place of business" is not defined by the New York Tax Law. It is defined by the Rules and Regulations of the New York State Tax Commission. (See *Matter of Clairmont Mills, Inc. v. New York State Tax Commission,* 11 AD 2d 368, 369 [3d Dept, 1960], 206 NYS2d 621, 622.) The definition which predates the enactment of the New York tax DISC legislation has been incorporated in the New York regulations for purposes of New York tax credit, although the regulations were not promulgated until after the years under review (State Tax Commission Reg, § 5-4.1 [20 NYCRR 5-4.1]). Under the requirements of the formula for computating the export tax credit, the mere shipment of export property from a New York facility is insufficient to qualify for the export tax credit nor do such shipments need to be made from a New York port in order to qualify for the credit.

In 1972, 4.771297% of the receipts from all sales of Westinghouse export property made by Westinghouse DISC were derived from sales in which the export property was shipped from a regular place of business of Westinghouse in New York. However, only .213235% of

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*Export property in general means property manufactured, produced, grown or extracted in the United States by a person other than a DISC, held primarily for sale, lease or rental, in the ordinary course of business by a DISC for disposition outside the United States and not more than 50% of the fair market value of which is attributable to articles imported into the United States.

the accumulated commission income of Westinghouse DISC was and could be deducted under the tax credit formula from the New York allocated and consolidated income of Westinghouse on which the New York franchise tax rate is applied. Similar results also pertain for 1973.

The computation of the DISC export credit allowed Westinghouse for 1972 is shown as follows:

DISC accumulated income		$13,390,500
Percentage of receipts of taxpayer's export property shipped from a place of business of Westinghouse in New York over all receipts from DISC's export sales	X	4.771297%
		638,900.52
Westinghouse's New York business allocation percentage	X	6.384454%
		40,790.31
Statutory reduction percentage	X	70%
		28,553.22
Tax rate	X	9%
Export tax credit		2,569.79

To enable a corporate shareholder of a DISC to make shipments of export property from a regular place of its business in New York, it is necessary for that corporation to have facilities and a staff in New York for that purpose. In providing such New York facilities and staff for shipments from a New York place of business the corporation's New York business allocation percentage would be increased because of higher New York property and payroll factors. Assuming the same total corporate income, its New York franchise tax would be higher, a result that would only be partially offset by the export tax credit.

The example given by Westinghouse to illustrate the application of the tax credit on page 17 of its brief distorts the effect of the credit. As discussed above, the business allocation percentage removes non-New York income from the base on which the New York tax is imposed. When shipments are made from a regular place of business of the taxpayer in New York, the New York business allocation increases as well as the New York tax base. These facts are ignored by Westinghouse.

New York taxes are among the highest in the nation. If other taxes which a corporation must pay to enable it to do business in New York can be considered, the alleged inducement of the tax credit to make shipments from a place of business in New York State becomes more unrealistic. The purpose of giving the tax credit is to prevent export business being driven out of New York and into States which follow the liberal tax treatment given DISC income by the Federal DISC legislation or which impose lower tax rates on such income than the rate being imposed on it by New York. The credit is designed to maintain export business in New York, principally manufacturing, by lowering the tax on such New York business. The tax credit merely lessens the New York tax computed on New York DISC income. If export business in New York decreased or was driven out of the State, the State would suffer a greater tax loss than that caused by the tax credit, as found by the New York Legislature. (See New York Legislative Annual, 1972, p 269).

Experience shows that since 1972 when the New York tax and credit provisions relating to DISCs were enacted, the percentage of United States exports from New York decreased. New York's share in 1972 was 7.6% and in 1980 it dropped to 5.9% as shown by the following table:

EXPORTS OF MANUFACTURED PRODUCTS UNITED STATES, NEW YORK AND OTHER SELECTED STATES*

	(millions of dollars)				Percent Change	
	1960	1972	1976	1980	1960-72	1972-80
United States	14,546	36,608	83,098	155,103	+151.7	+323.7
New York	1,211	2,795	5,320	9,168	+130.8	+228.0
Massachusetts	386	920	2,503	4,719	+138.3	+412.9
New Jersey	783	1,328	2,660	4,409	+ 69.6	+232.0
Pennsylvania	1,083	2,351	4,706	7,580	+117.1	+222.4

	Percent of United States			
	1960	1972	1976	1980
New York	8.3	7.6	6.4	5.9
Massachusetts	2.7	2.5	3.0	3.0
New Jersey	5.4	3.6	3.2	2.8
Pennsylvania	7.4	6.4	5.7	4.9

There is no basis to the claim that New York's scheme of DISC taxation diverts employment and business to New York State which might otherwise go to, and more efficiently be done in, some other State. The tax credit is in effect and in substance no different than a tax credit given for investments in New York which operate to lessen the New York tax on New York income aimed to encourage New York investments. The New York tax is limited to New York income. The tax credit is allowed against New York tax measured by income which is derived from and connected only with New York sources and as such does not discriminate against interstate commerce. It merely reduces New York taxes on New York export businesses.

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*Prepared in the New York State Department of Commerce, Division of Economic Research and Statistics. *Source:* U.S. Bureau of the Census, *Origin of Exports of Manufactured Products.*

CONCLUSION.

The judgment of the Court of Appeals of the State of New York should be affirmed.

Dated: Albany, New York
July 14, 1983

Respectfully submitted,

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CONSTITUTIONAL AND STATUTORY PROVISIONS AND REGULATIONS OF THE NEW YORK STATE TAX COMMISSION INVOLVED

United States Constitution

Article I, Section 8

The Congress shall have Power . . .

[3] To regulate Commerce with foreign Nations, and among the several States and with the Indian Tribes.

Amendment 14, Section 1

All persons born or naturalized in the United States, and subject to the jurisdiction thereof, are citizens of the United States and of the States wherein they reside. No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States, nor shall any State deprive any person of life, liberty or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.

New York Tax Law, Article 9-A

(as in effect in 1972 and 1973)

New York Tax Law § 208.

As used in this Article:

1. The term "corporation" includes a joint-stock company or association and any business conducted by a trustee or trustees wherein interest or ownership is evidenced by certificate or other written instrument; a "DISC" and a "former DISC" mean any corporation which meets the requirements of subsection (a) of section nine hundred ninety-two of the internal revenue code of nineteen hundred fifty-four. . . .

New York Tax Law §§ 208(8), 208(8-A)

8. The term "business income" means entire net income minus investment income;

8-A. Provided, however, that with respect to a DISC or a former DISC, the following provisions shall apply:

(a) investments in the stocks, bonds or other securities of a DISC or any indebtedness from a DISC shall not be treated as either subsidiary capital or investment capital under subdivisions four or five of this section,

(b) any amounts deemed distributed from a DISC or a former DISC which are taxable as dividends pursuant to subsection (b) of section nine hundred ninety-five of the internal revenue code of nineteen hundred fifty-four shall be treated as business income, except any such amounts from a former DISC attributable to amounts includible in a taxpayer's entire net income for a prior taxable year under subparagraph (B) of paragraph (i) of subdivision nine of this section shall be excluded from entire net income,

(c) any gain recognized for federal income tax purposes on the disposition of stock in a DISC, and any gain recognized on the disposition of stock in a former DISC, includible in gross income as a dividend pursuant to subsection (c) of section nine hundred ninety-five of the internal revenue code of nineteen hundred fifty-four, shall be treated as business income, and

(d) except as provided in paragraph (i) of subdivision nine of this section, any actual distribution from a DISC or a former DISC shall be treated as business income except an actual distribution which for federal income tax purposes is treated as made out of "other earnings and profits" under section nine hundred ninety-six of the internal revenue code of nineteen hundred fifty-four, in which case such actual distribution shall be treated as either subsidiary income or investment income under this article.

New York Tax Law § 208(9)(a)(1)

9. The term "entire net income" means total net income from all sources, which shall be presumably the same as the entire taxable income which the taxpayer is required to report to the United States Treasury Department, or which the taxpayer would have been required to report, if it had not made an election under subchapter s of chapter one of the internal revenue code, except as hereinafter provided, and subject to any modification required by paragraph (d) of subdivision three of section two hundred ten of this article.

(a) entire net income shall not include:

(1) income, gains and losses from subsidiary capital which do not include the amount of a recovery in respect of any war loss except for such amounts from a former DISC which are treated as business income under subdivision eight-A of this section . . . .

New York Tax Law § 208(9)(i)

(i) With respect to a DISC which during any taxable year or reporting year (1) received more than five percent of its gross sales from the sale of inventory or other property which it purchased from its stockholders, (2) received more than five percent of its gross rentals from the rental of property which it purchased or rented from its stockholders or (3) received more than five percent of its total receipts other than sales and rentals from its stockholders, the following provisions shall apply.

(A) For any taxable year in which sub-paragraph (B) of this paragraph is in effect and not rendered invalid, a DISC meeting the above test shall be exempt from all taxes imposed by this article.

(B) Supplemental to the provisions of subdivision five of section two hundred eleven of this article, any taxpayer required to compute a tax under this article, which during the taxable year being reported was a stockholder in any

DISC meeting the test prescribed in this paragraph, shall for any taxable year ending after December thirty-first, nineteen hundred seventy-one adjust each item of its receipts, expenses, assets and liabilities, as otherwise computed under this article, by adding thereto its attributable share of each such DISC's receipts, expenses, assets and liabilities as reportable by each such DISC to the United States Treasury Department for its annual reporting period ending during the current taxable year of such taxpayer; provided, however, (1) that all transactions between the taxpayer and each such DISC shall be eliminated from the taxpayer's adjusted receipts, expenses, assets and liabilities; (2) that the taxpayer's entire net income as otherwise computed under this section, shall be reduced by subtracting the amount of the deemed distribution of current income, if any, from each such DISC already included in the entire net income of such taxpayer by virtue of having been included in its entire taxable income for that taxable year as reported to the United States Treasury Department; and (3) that in the event this paragraph should be rendered invalid, all DISCs and their stockholders taxable hereunder shall be taxed instead under the remaining portions of this article.

New York Tax Law § 209 (1)

1. For the privilege of exercising its franchise or doing business in this state in a corporate or organized capacity for all or any part of each of its fiscal or calendar years . . . every domestic or foreign corporation, except corporations specified in subdivision four of this section, shall annually pay a franchise tax, upon the basis of its entire net income, or upon such other basis as may be applicable as hereinafter provided, . . . and [the tax] shall be paid as hereinafter provided.

New York Tax Law § 209 (6)

6. For any taxable year of a DISC, not exempt from tax under paragraph (i) of subdivision nine of section two hundred eight of this article, the taxes imposed by subdivision one of this

section shall be computed only under either clause two or clause four of paragraph (a) of subdivision one of section two hundred ten of this chapter, whichever is greater, and paragraph (b) of such subdivision.

New York Tax Law §§ 210(1)-210(3)

1. The tax imposed by subdivision one of section two hundred nine of this chapter shall be, in the case of each taxpayer:

(a) a tax (1) computed at the rate of nine per centum on its entire net income, or the portion thereof allocated within the state as hereinafter provided, subject to any modification required by paragraph (d) of subdivision three of this section, or (2) computed at one and six tenths mills for each dollar of its total business and investment capital, or the portion thereof allocated within the state as hereinafter provided, except that in the case of a cooperative housing corporation as defined in the internal revenue code or in the case of a housing company organized and operating pursuant to the provisions of article two of the private housing finance law, the applicable rate shall be four-tenths of a mill, or (3) computed at the rate of nine per centum on thirty per centum of the taxpayer's entire net income plus salaries and other compensation paid to the taxpayer's elected or appointed officers and to every stockholder owning in excess of five per centum of its issued capital stock minus fifteen thousand dollars (except as hereinafter provided) and any net loss for the reported year, or on the portion of such sum allocated within the state as hereinafter provided for the allocation of entire net income, subject to any modification required by paragraph (d) of subdivision three of this section, or (4) one hundred dollars, whichever is greatest, plus

(b) a tax computed at the rate of eight-tenths of a mill for each dollar of the portion of its subsidiary capital allocated within the state as hereinafter provided.

(c) In the case of a taxpayer which is not subject to tax for an entire year the exemption allowed in clause three

of paragraph (a) of this subdivision shall be prorated according to the period such taxpayer was subject to tax.

(d) If the taxable period for which the tax is due is less than an entire year, the minimum tax fixed by clause four of paragraph (a) of this subdivision shall be reduced by twenty-five per centum if the period for which such taxpayer is subject to tax is more than six months but not more than nine months and by fifty per centum if the period for which such taxpayer is subject to tax is not more than six months.

1-a. Notwithstanding any other provision of this chapter, an additional tax computed at the rate of five and three-quarters per centum on business income, or the portion thereof allocated within the state as hereinafter provided, is hereby imposed on every corporation subject to the tax imposed by this article which has gross receipts of five hundred thousand dollars or more for the taxable year from transportation, within this state, by omnibuses having a seating capacity of more than seven persons, other than receipts for the operation of school buses which are excluded from entire net income.

1-b. The computation specified in clause three of paragraph (a) of subdivision one shall not apply to a corporation organized under article fifteen of the business corporation law.

2. The amount of subsidiary capital, investment capital and business capital shall each be determined by taking the average fair market value of the gross assets included therein (less, in the case of business capital, average liabilities deductible therefrom which are payable by their terms on demand or within one year from the date incurred, other than loans or advances outstanding for more than a year as of any date during the year covered by the report, and, if the period covered by the report is other than a period of twelve calendar months, by multiplying such value by the number of calendar months or major parts thereof included in such period, and dividing the product thus obtained by twelve[)].

3. The portion of the entire net income of a taxpayer to be allocated within the state shall be determined as follows:

(a) multiply its business income by a business allocation percentage to be determined by

(1) ascertaining the percentage which the average value of the taxpayer's real and tangible personal property within the state during the period covered by its report bears to the average value of all the taxpayer's real and tangible personal property wherever situated during such period;

(2) ascertaining the percentage which the receipts of the taxpayer, computed on the cash or accrual basis according to the method of accounting used in the computation of its entire net income, arising during such period from

(A) sales of its tangible personal property where shipments are made to points within this state,

(B) services performed within the state,

(C) rentals from property situated, and royalties from the use of patents or copyrights, within the state, and

(D) all other business receipts earned within the state, bear to the total amount of the taxpayer's receipts, similarly computed, arising during such period from all sales of its tangible personal property, services, rentals, royalties and all other business transactions, whether within or without the state;

(3) ascertaining the percentage of the total wages, salaries and other personal service compensation, similarly computed, during such period of employees within the state, except general executive officers, to the total wages, salaries and other personal service compensation, similarly computed, during such period of all the taxpayer's employees within and without the state, except general executive officers; and

(4) adding together the percentages so determined and dividing the result by the number of percentages; provided, however, that if the taxpayer does not have a regular place of business outside the state other than a statutory office, the business allocation percentage shall be one hundred percent;

Provided, however, that any taxpayer required to adjust its receipts, expenses, assets and liabilities by adding an attributable portion of the receipts, expenses, assets and liabilities of any DISC, as provided by paragraph (i) of subdivision nine of section two hundred eight of this article, shall substitute such adjusted figures in computing the percentages required in subparagraphs one, two and three of this paragraph.

(b) multiplying its investment income by an investment allocation percentage to be determined by

(1) multiplying the amount of its investment capital invested in each stock, bond or other security (other than governmental securities) during the period covered by its report by the percentage, if any, of the entire capital or the issued capital stock, or the gross direct premiums, or the net income, as the case may be, of the issuer or obligor thereof required to be allocated within the state on the report or reports, if any, required of any such issuer or obligor under this chapter or the insurance law for the preceding year, but without regard to any minimum,

(2) adding together the sums so obtained, and

(3) dividing the result so obtained by the total of its investment capital invested during such period in stocks, bonds and other securities (other than obligations of the United States and its instrumentalities and obligations of the state of New York, its political subdivisions and its instrumentalities); provided, however, that in case any investment capital is invested in any stock, bond or other security during only a portion of the period covered by the report, only such portion of such capital shall be taken into account; and provided further, that if a taxpayer's investment allocation percentage is zero, interest received on

bank accounts, on obligations of the United States and its instrumentalities and on obligations of the state of New York, its political subdivisions and its instrumentalities shall be multiplied by its business allocation percentage; provided, however, that with respect to corporations organized under article fifteen of the business corporation law, the investment allocation percentage shall be one hundred percent; and

(c) add the products so obtained.

(d) At the election of the taxpayer there shall be deducted from the portion of its entire net income allocated within the state either or both of the items set forth in subparagraphs one and two of this paragraph, except that only one of such deductions shall be allowed with respect to any one item of property.

New York Tax Law § 210(13)

13. (a) So long as the taxation procedures relating to a DISC provided in subparagraph (B) of paragraph (i) of subdivision nine of section two hundred eight of this article are in effect and not rendered invalid any taxpayer which during the taxable year being reported was a stockholder in any such DISC shall be allowed a DISC export credit, to be computed as hereinafter provided, against the tax imposed by this article after allowance of any credit permitted under subdivision eleven and subdivision twelve of this section. The amount of the credit shall be computed separately for each such DISC, based upon its operations during its annual reporting period ending the current taxable year of such stockholder, as follows:

(1) ascertaining the amount, if any, of such taxpayer's attributable share of the total current earnings and profits earned by such DISC for the reporting year which were included in its accumulated DISC income account pursuant to subsection (a) of section nine hundred ninety-six of the internal revenue code of nineteen hundred fifty-four,

(2) ascertaining a percentage by (i) totaling the gross receipts from the sale, lease, rental or other disposition of export property (as defined under subsection (c) of section nine hundred ninety-three of the internal revenue code of

nineteen hundred fifty-four) of the taxpayer by or to such DISC, and (ii) totaling such gross receipts from such export property of the taxpayer shipped from a regular place of business of the taxpayer within this state by or to such DISC and then (iii) dividing the total developed in (ii) above by that developed in (i) above (provided, however, for the purposes of this subparagraph, the tax commission may require such gross receipts to be computed on a similar basis for all such export property to properly reflect the percentage of such gross receipts attributable to export property shipped from a regular place of business of the taxpayer within this state),

(3) multiplying the amount ascertained in subparagraph one of this paragraph by the percentage ascertained in subparagraph two of this paragraph,

(4) ascertaining the amount of the taxpayer's taxable income as determined in subparagraphs one, two and three of this paragraph that is eligible for credit by multiplying the product ascertained in the preceding subparagraph by the taxpayer's business allocation percentage determined as provided in paragraph (a) of subdivision three of this section,

(5) the amount of DISC export credit attributable to the operations of each such DISC is then found by multiplying seventy percent of the taxpayer's taxable income that is eligible for credit, as computed in the preceding subparagraph, by the rate of tax applying to the taxpayer, as provided in subdivision one of this section,

(6) the taxpayer's total DISC export credit is the sum of the DISC export credits attributable to each DISC that qualifies for tax exemption under paragraph (i) of subdivision nine of section two hundred eight of this article, in which it was a stockholder during the taxable year being reported.

(b) The credit allowed under this subdivision for any taxable year shall not reduce the tax due for such year to less

than one hundred twenty-five dollars; nor may any unused credit be carried over to any following year.

New York Tax Law § 211(3)

1. Every taxpayer, as well as every foreign corporation having an officer, agent or representative within the state, shall annually on or before March fifteenth transmit to the tax commission a report in a form prescribed by it (except that a corporation which reports on the basis of a fiscal year shall transmit its report within two and one-half months after the close of its fiscal year and except, also, that a corporation which is a DISC shall transmit its report on or before the fifteenth day of the ninth month following the close of its calendar or fiscal year), setting forth such information as the tax commission may prescribe and every taxpayer which ceases to exercise its franchise or to be subject to the tax imposed by this article shall transmit to the tax commission a report on the date of such cessation or at such other time as the tax commission may require covering each year or period for which no report was theretofore filed. Every taxpayer shall also transmit such other reports and such facts and information as the tax commission may require in the administration of this article. The tax commission may grant a reasonable extension of time for filing reports whenever good cause exists.

An automatic extension of three months for the filing of its annual report shall be allowed any taxpayer if, within the time prescribed by the preceding paragraph, such taxpayer files with the tax commission an application for extension in such form as said commission may prescribe by regulation and pays on or before the date of such filing the amount properly estimated as its tax.

New York Tax Law § 211(4)

4. In the discretion of the tax commission, any taxpayer, which owns or controls either directly or indirectly substantially all the capital stock of one or more corporations, or substanially

all the capital stock of which is owned or controlled either directly or indirectly by one or more other corporations or by interests which own or control either directly or indirectly substantially all the capital stock of one or more other corporations, may be required or permitted to make a report on a combined basis covering any such other corporations and setting forth such information as the tax commission may require; provided, however, that any corporation which owns or controls either directly or indirectly substantially all the capital stock of a DISC not exempt from tax under paragraph (i) of subdivision nine of section two hundred eight of this article shall be allowed, at the election of such corporation, to make a report on a combined basis covering such DISC, but the failure of such corporation to make such election shall not prohibit the tax commission from requiring a combined report covering such corporation and such DISC; provided, further, that no combined report covering any corporation not a taxpayer shall be required unless the tax commission deems such a report necessary, because of inter-company transactions or some agreement understanding, arrangement or transaction referred to in subdivision five of this section, in order properly to reflect the tax liability under this article. In the case of a combined report the tax shall be measured by the combined entire net income or combined capital, of all the corporations included in the report. In computing combined entire net income intercorporate dividends shall be eliminated, in computing combined business and investment capital intercorporate stockholdings and intercorporate bills, notes and accounts receivable and payable and other intercorporate indebtedness shall be eliminated and in computing combined subsidiary capital intercorporate stockholdings shall be eliminated, provided, however, that intercorporate dividends from a DISC or a former DISC not exempt from tax under paragraph (i) of subdivision nine of section two hundred eight of this article which are taxable as business income under this article shall not be eliminated.

§ 211(5)

"5. In case it shall appear to the tax commission that any agreement, understanding or arrangement exists between the taxpayer and any other corporation or any person or firm, whereby the activity, business, income or capital of the taxpayer within the state is improperly or inaccurately reflected, the tax commission is authorized and empowered, in its discretion and in such manner as it may determine, to adjust items of income, deductions and capital, and to eliminate assets in computing any allocation percentage provided only that any income directly traceable thereto be also excluded from entire net income, so as equitably to determine the tax. Where (a) any taxpayer conducts its activity or business under any agreement, arrangement or understanding in such manner as either directly or indirectly to benefit its members or stockholders, or any of them, or any person or persons directly or indirectly interested in such activity or business, by entering into any transaction at more or less than a fair price which, but for such agreement, arrangement or understanding, might have been paid or received therefor, or (b) any taxpayer, a substantial portion of whose capital stock is owned either directly or indirectly by another corporation, enters into any transaction with such other corporation on such terms as to create an improper loss or net income, the tax commission may include in the entire net income of the taxpayer the fair profits which, but for such agreement, arrangement or understanding, the taxpayer might have derived from such transaction."

REGULATIONS OF THE NEW YORK STATE TAX COMMISSION (20 NEW YORK CODE OF RULES AND REGULATIONS)

DISC EXPORT CREDIT

Historical Note

Subpart (§§ 5-4.1—5-4.3) filed Aug. 31, 1976 eff. for all taxable years beginning on or after Jan. 1, 1976.

Section 5-4.1 General. [Tax Law, § 210(13)] Taxpayers that are stockholders of a tax exempt DISC are entitled to a DISC export credit if the export property, as defined in section 993 of the Internal Revenue Code, is shipped from the stockholder's regular place of business in New York State. A regular place of business is any bona fide office (other than a statutory office), factory, warehouse or other space which is regularly used by the taxpayer in carrying on its business.

Historical Note

Sec. filed Aug. 31, 1976; amd. filed April 1, 1981; eff. April 1, 1981.

5-4.2 Computation of the DISC export credit. [Tax Law, § 210(13)(a)] (a) The DISC export credit is computed as follows:

(1) Ascertain the taxpayer's attributable share of the total current earnings and profits earned by the DISC for the reporting period which is included in the accumulated DISC income account (see section 5-9.7 of this Title—Rules for treatment of earnings and profits).

(2) Ascertain a percentage by dividing the total of subparagraph (ii) by the total of subparagraph (i) of this paragraph.

(i) Determine the total gross receipts of the taxpayer from the sale, lease, rental or other disposition of its export property (not receipts from services or other types of property) by the DISC on behalf of the taxpayer, or from the sale, lease or rental of such property to the DISC.

(ii) Determine the total of the gross receipts described in subparagraph (i) of this paragraph, from the sale, lease, rental or other disposition of such export property which are shipped from a regular place of business of the taxpayer in New York State. For example, export property sold to the DISC and shipped by the taxpayer from its warehouse in New York State directly to the DISC's customers outside New York State or export property sold by the DISC as agent for the taxpayer and shipped by the taxpayer from its plant in New York State to the DISC outside New York State for subsequent shipment to the customer outside New York State.

(3) Multiply the amount ascertained in paragraph (1) of this subdivision by the percentage ascertained in paragraph (2) of this subdivision.

(4) Multiply the amount ascertained in paragraph (3) of this subdivision by the business allocation percentage computed on the stockholder's consolidated report for the taxable year.

(5) Multiply the amount ascertained in paragraph (4) of this subdivision by 70 percent.

(6) The amount determined in paragraph (5) of this subdivision is multiplied by the

5-4.3 Limitation and sequence of credits against tax. [Tax Law, § 210(13)]

(a) Credits against the tax allowable in this Subpart and this Part are applied in the following sequence:

(1) credit for eligible business facility (Subpart 5-1 of this Part);

(2) credit for sales or compensating use taxes on any catalytic, purifying or bleaching chemical agent (Subpart 5-5 of this Part);

(3) credit for sales or compensating use taxes on tangible personal property used in industrial waste treatment or pollution abatement (Subpart 5-6 of this Part);

(4) investment tax credit (Subpart 5-2 of this Part);

(5) employment incentive tax credit (Subpart 5-3 of this Part);

(6) DISC export credit (this Subpart); and

(7) the special additional mortgage recording tax credit (Subpart 5-7 of this Part).

(b) In no event may the tax due be less than the minimum tax described in section 3-5.1 of this Title. If after applying the investment tax credit and the employment incentive tax credit, the tax is the minimum tax, the DISC export credit is not allowed.

(c) There is no carry-over of the credits described in paragraph (1), (2), (3) or (6) of subdivision (a) of this section.

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No. 81-2394

In The

Supreme Court of the United States

October Term, 1983

WESTINGHOUSE ELECTRIC CORPORATION,
Appellant,

—against—

JAMES H. TULLY, JR., *et al.*,
AS THE TAX COMMISSION OF THE STATE OF NEW YORK,
Appellees.

ON APPEAL FROM THE COURT OF APPEALS OF THE STATE OF NEW YORK

REPLY BRIEF OF APPELLANT

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REPLY BRIEF OF APPELLANT

Appellees' basic argument appears to be simple. Appellees admit that New York is attempting to tax income earned from transactions in which exports are "shipped from a regular place of business . . . within" New York, N.Y. Tax Law §210.13(a)(2), at a lower rate than income earned from exports shipped from outside the state. (Appellees' Brief at 15, 21.) They claim, however, that this discrimination is constitutionally permissible because the differential tax rate is applied only to New York's apportioned share of the combined net income of appellant Westinghouse Electric Corp. ("Westinghouse") and its wholly owned DISC subsidiary, Westinghouse Electric Export Corporation ("Westinghouse Export" or "Export").

Appellees' reliance on the distinction between apportioned and unapportioned taxes is misplaced. Whether a discriminatory tax rate applies to all of a taxpayer's net income or only to an allocated portion of it makes no constitutional difference. The fact is that the amount of tax paid with respect to income from particular transactions will be lower if the transactions occur in-state than if they occur out-of-state. Such a differential tax rate depending on the location of business activity is precisely the kind of taxing scheme struck down by this Court in *Boston Stock Exchange v. State Tax Commission*, 429 U.S. 318 (1977).

Assume that a corporation has all of its payroll, property and revenue located in New York apart from a permanent shipping facility of insignificant size located in New Jersey. A very large part of that corporation's income would be taxable in New York. When confronted with the decision whether to ship its export products from New Jersey or New York, that corporation would be confronted with the fact that DISC income derived from a New Jersey shipment would bear tax at a rate of 9%, while income derived from a New York shipment would be taxed at 2.7%. It is that undeniably discriminatory effect which invalidates New York's tax. And that discriminatory effect exists whether New York, because of the geographical dispersion of a taxpayer's business, taxes 5% or 100% of its income.

As a matter of mathematical logic, appellees' position makes no sense. When an allocation percentage, say 5%, is applied to a net income figure, the mathematical effect is that 5% of every item of income of the taxpayer is taken and totaled together. Use of an allocation percentage is merely a way of approximating what amount of a corporation's total income is attributable to its activities in a particular state. This method is used as a convenient substitute for accounting for the state-by-state origin of each dollar of a multi-state corporation's net income. But it necessarily means that, contrary to appellees' position, the amount of money which New York taxes after the allocation formula is applied is derived in identical fractions from each item of income of Westinghouse and Export. Thus,

New York's 5% allocated share of Westinghouse's income necessarily includes 5% of Westinghouse's income from its New York operations, 5% of Westinghouse's income from out-of-state operations, 5% of Export's income from export shipments made from within New York, and 5% of Export's income from export shipments made from outside New York. Appellees are therefore simply wrong when they say that New York "never taxed in the first instance" any out-of-state income. (Appellees' Brief at 19.) Income from out-of-state sales is being taxed, and when such income is accumulated DISC income, it is being taxed at more than three times the rate of in-state accumulated DISC income. (*See* Appellant's Brief at 17.)

The fallacy in appellees' position is highlighted by their claim that New York's limitation on the export credit does "not affect interstate commerce in any greater degree than any other state tax or credit on business income." (Appellees' Brief at 19.) In fact, other typical kinds of credits based on in-state activity, such as those noted by California in its brief (Amicus Brief at 2), are granted in a manner that is distinguishable from New York's export credit. These credits are different from New York's because they are calculated solely on the basis of investments or expenditures made by the taxpayer within the taxing state. For example, an investment of $1 million in a new plant in a state might entitle a taxpayer to an investment tax credit of 10% or $100,000 against the franchise tax otherwise payable. The direct effect of such a credit is to reduce the effective cost to the taxpayer of making a particular expenditure. A credit that is measured by the amount of in-state investment or expenditure thus rewards in-state activity, but it does not at the same time inflict a penalty if the taxpayer chooses to make such investments elsewhere. On the other hand, use of a ratio such as New York's comparison in this case of the gross amount of in-state export shipments to out-of-state export shipments is unconstitutional because its effect is to punish the taxpayer for having engaged in business activity outside the state. The amount of the credit decreases as out-of-state activity increases relative to New York activity; the

taxpayer is penalized by increased New York taxes for every shipment that it makes from out-of-state.[1]

Nor can appellees' claim that New York is merely giving up part of the tax payable on income that the State is constitutionally permitted to tax at whatever rate it chooses withstand analysis. While it is true that the Constitution may not require New York to give any tax credit on accumulated DISC income, and that, more generally, New York may impose a franchise tax at any rate it chooses, once the State has determined to grant a credit, the credit itself must be computed in a constitutionally allowable manner. To use a hypothetical example, there can be no doubt that a tax credit which depended upon the race or national origin of a corporate taxpayer's stockholders would be unconstitutional. The constitutional equation would not be altered by the fact that the state was taxing only a properly apportioned share of the corporation's income. When the state determines how to tax its apportioned share, relief from the tax so imposed must be granted in a constitutionally proper manner. Just as discrimination in the tax rate on the basis of race would be unconstitutional, so, under *Boston Stock Exchange v. State Tax Commission*, 429 U.S. 318 (1977) and *Maryland v. Louisiana*,

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[1] For example, assume that a taxpayer which is a combined parent-DISC entity has gross receipts of $1,000 from the shipment of export property from a regular place of business in New York and gross receipts of $1,000 from export shipments from a regular place of business in California. Assume further that the income derived from that $2,000 in export shipments is $200 and that the taxpayer's New York allocation percentage is 50%. In that case, New York could tax $100 of the taxpayer's export income. The DISC export credit would be calculated by taking the taxpayer's accumulated DISC income, which can be no more than half of total export income, 26 U.S.C. § 995, or $100, and multiplying that amount, first by the proportion of New York export shipments to all shipments (50%), and then by New York's allocation percentage (also 50%). *See* N.Y. Tax Law §210.13(a). The product, $100 x 50% x 50% = $25, is the amount eligible for the DISC export credit. That amount is then multiplied by 70% and by the tax rate (9% for the years in question) to ascertain the amount of the credit: $25 x 70% x 9% = $1.575. The net tax bill

451 U.S. 725 (1981), discrimination against business operations conducted in other states is forbidden as well.[2]

Both appellees and amicus, the State of California, argue that *Boston Stock Exchange* and *Maryland v. Louisiana* are distinguishable because neither case involved an apportioned tax. That distinction is irrelevant. In both cases, there was no question that the state had the constitutional power to impose some tax because a taxable incident had occurred within the state's borders. Similarly here, there is no doubt that New York may impose a tax on the net income of corporations which do business in the State. An apportionment formula is merely

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would then be $100 of export income allocable to New York multiplied by the 9% tax rate, or $9.00, less the credit of $1.575, or $7.43.

Now assume that the same taxpayer decides to double its California export operations while maintaining precisely the same export operations in New York, and assume that the new California operations generate profit at the same rate as the old, but will require increased property and payroll in that state such that New York's allocation percentage drops to 33⅓%. Thus, the taxpayer will have total export receipts of $3,000 and export income of $300. Of this $300 in export income, New York's dollar share remains at $100—as it logically should since the taxpayer's New York operations are unchanged in amount—and the tax payable before operation of the credit remains $9.00. However, the credit will be smaller: The taxpayer now has $150 in accumulated DISC income which is multiplied by New York's share of export shipments (now 33⅓%) and by New York's allocation percentage (also 33⅓%), giving $150 x 33⅓% x 33⅓% = $16.67, and resulting in a credit of $1.05 ($16.67 x 70% x 9% = $1.05). Thus, the net tax increases from $7.43 to $7.95 solely because the taxpayer chose to increase its California export operations.

[2] The constitutional problem is exacerbated when a state seeks to impose a tax on a unitary combined return basis on affiliated corporations such as Westinghouse and Export. In the case of such a tax, not only "[t]he corporate boundaries are ignored" (Amicus Brief at 3), but state boundaries are also ignored in computing the total income to be reached on a unitary basis. Yet in granting a credit such as New York's in this case, corporate boundaries are carefully observed by limiting the credit to shipments from a regular place of business of the taxpayer (*i.e.*, Westinghouse, and not Westinghouse's non-New York affiliates) and state boundaries become crucial as well, since the taxpayer's regular place of shipment must be located in New York to qualify for the credit.

another way in which New York imposes its taxes on multi-state enterprises under the limitations of the Due Process and Commerce Clauses. By no means, however, does the use of a proper apportionment formula immunize all aspects of the tax from scrutiny.

Put another way, the business activities which the states sought to tax in *Boston Stock Exchange* and *Maryland v. Louisiana* were activities of which elements took place both in-state and out-of-state. The in-state elements were sufficient to give the state the power to tax the activity. Both taxes were struck down because the amount of tax payable depended on whether particular aspects of the transactions occurred in-state or out-of-state. Similarly here, Westinghouse's export activities (in the aggregate) have both in-state and out-of-state elements and the amount of credit granted on account of such activities depends on the location (in the aggregate) of transactions within or outside of the state.

Appellees also contend that the limitation on the export credit is proper because the state "has simply chosen to tax that part of the taxpayer's New York income stemming from *exports* (New York related exports since only New York income is being taxed) at a lesser rate than *non-export* New York income." (Appellees' Brief at 20; emphasis added.) This contention is erroneous, first, because while only an apportioned share of Westinghouse's income is being taxed, that share does include income from export shipments from outside New York.[3] Second, the export credit does not in fact differentiate between export and non-export income. The amount of the credit is based (as appellees elsewhere acknowledge, Brief at 23) on the ratio of a taxpayer's sales receipts from exports shipped from a regular place of business within New York to the taxpayer's total receipts from exports. The amount of the credit is not—as appellees' argument implies—based on the ratio of Westinghouse Export's income (which is by definition entirely export-related income) to the total income of Westinghouse and Westinghouse Export combined. Such a ratio, based on the type of transaction which generates the income,

[3] *See supra* pp. 2-4.

might be constitutionally allowable. But that is very different from a ratio based on the location of a particular type of transaction.[4]

Appellees make the remarkable argument that the export credit does not "provide a significant inducement to corporations to conduct export businesses . . . in New York." (Appellees' Brief at 21.) Apparently to make the same point, they also present statistics purporting to show that New York's share of the nation's export business has declined since 1972 when special tax treatment of DISCs was initiated. These arguments are irrelevant, for this Court "need not know how unequal [a tax] is before concluding that it unconstitutionally discriminates." *Maryland v. Louisiana*, 451 U.S. at 760. In any

[4] Moreover, appellees' argument implicitly assumes that the method used to calculate the amount of the credit (ratio of shipments from in-state places of business to shipments from out-of-state places of business) properly attributes net income to the State. This assumption is wrong because the place of shipment does not necessarily have any relation to the place in which net income is actually earned.

The "parade of horrors" presented in the California amicus brief (at 11) is based on hypotheticals which are simply not analogous to the tax at issue here. California claims that the logical extension of Westinghouse's argument would be to invalidate state tax laws which impose no tax whatsoever on DISC income. This example only serves to confirm Westinghouse's claims, however, for it assumes that the state is refusing to tax *all* of a taxpayer's DISC income rather than discriminatorily exempting DISC income assumed to be derived from New York shipments. The proper analogy to this case is a tax scheme which imposed no tax only on the apportioned in-state share of a taxpayer's DISC income, but included in taxable income all DISC income attributable to out-of-state sources. Westinghouse's argument would require invalidation only of the second type of tax. For the same reasons, adoption of Westinghouse's position would not make it unconstitutional for a state to abolish its corporate income tax nor would it require states to impose such taxes or to impose them at a uniform rate. Changing the overall rate across the board, or abolishing a tax entirely, is clearly permissible. What is unconstitutional is manipulating the effective tax rate so that in-state business activities result in a lower tax rate than income generated from out-of-state activities.

event, appellees' claims fly in the face of common sense as well as the express findings of the Court of Appeals and the New York Legislature. The legislative history of the credit indicates that it was intended to "provide a positive incentive" and a "tax advantage" "for increased business activity in New York State."[5] The Court of Appeals acknowledged that the purpose of the credit was to provide "State tax incentives" "to ensure that New York would not lose its competitive position vis-a-vis other States". (J.A. 63-64.) These statements, which clearly establish New York's discriminatory purpose, foreclose any justification of the export credit based on an alleged de minimis effect.[6]

Appellees and amicus criticize Westinghouse for arguing (Appellant's Brief at 21-22) that the discriminatory effect in limiting the DISC export credit to New York shipments is exacerbated by the requirement that the income and expenses of a DISC be combined with those of its parent, N.Y. Tax Law §208.9(i)(B), without an adjustment in the apportionment formula to take account of the payroll, property and receipts of Westinghouse's "non-New York affiliates" (*i.e.*, subsidiaries of Westinghouse which admittedly do no business whatever in New York and are not taxed by the State) whose business activities contributed 20-25% of Export's income. Appellees

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[5] New York Division of the Budget, Report on A. 12108-A and S. 10544 (May 23, 1972), *reprinted in* Bill Jacket of 1972 N.Y. Laws, ch. 778, at 13, 18; New York Department of Commerce, Memorandum Recommending Approval of Assembly Bill A. 12108-A (May 24, 1972), *reprinted in* Bill Jacket of 1972 N.Y. Laws, ch. 778, at 9, 11.

[6] Indeed, one provision of the Louisiana First-Use Tax struck down in *Maryland v. Louisiana*, 451 U.S. 725 (1981), was a "Severance Tax Credit." In finding that such credit discriminated against interstate commerce, this Court used language that is equally applicable here in light of the avowed purpose and plain effect of New York's export credit:

> "The obvious economic effect of this Severance Tax Credit is to encourage natural gas owners involved in the production of OCS gas to invest in mineral exploration and development within Louisiana rather than invest in further OCS development or in production in other States."

451 U.S. at 757. Limiting the New York export credit to in-state shipments similarly encourages investment in New York for export shipping facilities at the expense of other states.

themselves, however, place fundamental reliance on the apportionment formula as ensuring that "[o]nly the New York portion of the entire consolidated net income" of Westinghouse and Export is taxed. (Appellees' Brief at 16-17.) They claim that the use of the resulting business allocation percentage in computing the export credit saves the credit from attack. (Appellees' Brief at 26.) But, if the apportionment formula is not in fact fairly applied, the entire premise of appellees' justification for the export credit fails.

The problems that may arise from use of an apportionment formula in the particular context of required combined reporting by a parent corporation and a DISC subsidiary, set up essentially as an accounting convention, cannot be ignored. While there is no difficulty if the only income of such a DISC is derived from transactions with or on behalf of its parent, where—as is admittedly true in this case—the DISC also has income generated from transactions with or on behalf of other affiliates that do no business in the taxing state, apportionment solely on the basis of the property, wages and receipts of the combined parent-DISC entity allows a state to reach out and tax income generated by out-of-state activities of the non-New York affiliates. This income is reached by New York only because it happens to flow through the DISC accounting structure.[7]

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[7] In addition, because the combined reporting requirement is triggered by the fact that the taxpayer "was a stockholder" in the DISC, N.Y. Tax Law §208.9(i)(B), and not by a determination that the entire income of the DISC was earned as part of a unitary business conducted by the taxpayer, it improperly attributes all of Export's income to Westinghouse (by virtue of its 100% stock ownership in Export) when in fact—as is undisputed—only 75 to 80% of Export's income represents value attributable to Westinghouse's activities. The remaining 20 to 25% for the years in question was value attributable to the non-New York affiliates, which appellees concede they have no power to tax.

DISC income differs from ordinary commercial income. DISC income is basically the result of an accounting segregation permitted by the Internal Revenue Code. The property, payroll and receipts which produced the income so segregated with respect to the exports of Westinghouse's non-New York affiliates is that of those non-New York affiliates—property, payroll and receipts which New York improperly ignores by excluding them from the denominator of its apportionment formula.

CONCLUSION

For the foregoing reasons and those stated in the Brief of Appellant, the judgment of the Court of Appeals should be reversed and the case remanded for assessment of Westinghouse's franchise tax liability in conformity with the Commerce Clause of the United States Constitution and the Equal Protection and Due Process Clauses of the Fourteenth Amendment.

October 25, 1983

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In the Supreme Court

OF THE

United States

OCTOBER TERM, 1982

WESTINGHOUSE ELECTRIC CORPORATION, *Appellant*,

vs.

JAMES H. TULLY, JR., et al.,
As The Tax Commission Of The State Of New York,
Appellees.

On Appeal From The Court Of Appeals Of The State Of New York

BRIEF OF THE STATE OF CALIFORNIA AS AMICUS CURIAE IN SUPPORT OF BRIEF OF JAMES H. TULLY, JR.

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BRIEF OF THE STATE OF CALIFORNIA AS AMICUS CURIAE IN SUPPORT OF BRIEF OF JAMES H. TULLY, JR.

INTEREST OF THE AMICUS CURIAE

The state of California, pursuant to Rule 36.2 of the Rules of the Supreme Court of the United States, submits this brief as amicus curiae in support of the Appellees, James H. Tully, Jr., et al.

The state of California imposes a franchise tax and a corporate net income tax (Cal. Rev. & Tax Code §§ 23001 et seq.) on corporations incorporated, qualified, doing busi-

ness in or having income from sources in California. In determining the amount of income of a corporation that is properly attributable to activities within its jurisdiction, California relies upon the unitary business principle which encompasses both formulary apportionment and the combined report procedure. (*Container Corporation of America v. Franchise Tax Board*, Docket No. 81-523, decided June 27, 1983.)

The state of California also provides credits, deductions and exemptions to encourage corporations to make investments in various properties or engage in particular activities within California which have been determined to be beneficial to the population and economy of the state as a whole. These include, but are not limited to: (1) procuring of goods and services in California (Rev. & Tax. Code § 23101.5(a)(1)), (2) sending employees to California educational institutions (Rev. & Tax. Code § 23101.5 (a)(2)), (3) use of solar energy devices (Rev. & Tax. Code § 23601), (4) use of energy conservation measures (Rev. & Tax. Code § 23601.5), (5) improved agricultural irrigation equipment (Rev. & Tax. Code § 23602), (6) conversion of cars and trucks to use alcohol (Rev. & Tax. Code § 23603), (7) installation of pollution control equipment (Rev. & Tax. Code § 23604), (8) employee ridesharing programs (Rev. & Tax. Code § 23605), (9) use of solar-powered irrigation pumps (Rev. & Tax. Code § 23606), (10) foreign-flag sea and air carriers (Rev. & Tax. Code § 24320), (11) targeted jobs credit (Rev. & Tax. Code § 24330), (12) child development service facilities (Rev. & Tax. Code § 24371.5), and (13) forest land improvements (Rev. & Tax. Code § 24372.5). Each of these credits, deductions or exemptions

is only available with respect to activities and investments in California regardless of the fact that a taxpayer's activities are carried on throughout the world.

The state of California's interest in this issue is substantially identical to that of the state of New York. The propriety of the combined report or consolidated return methodology involves more than $1.7 billion in annual revenues to California. The credits, deductions and exemptions given solely with respect to California activities exceed $3.2 million annually. The state of California has a vital interest in the proper application of the unitary business principle and in its ability to encourage appropriate business expenditures and locational decisions.

Under Rule 36.4 of the Rules of the Supreme Court of the United States, the state of California is not required to obtain the consent of the parties to file an amicus curiae brief.

SUMMARY OF ARGUMENT

Westinghouse Electric Corporation (Westinghouse) and Westinghouse Electric Export Corporation (Export) are engaged in a unitary business; therefore, the use of a combined report or consolidated return to determine the income attributable to New York is proper.[1]

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[1]A distinction should be made between a combined report and a consolidated return. A consolidated return treats the activities of several corporations as if they were conducted by a single corporation. The corporate boundaries are ignored. (See Internal Revenue Code, §§ 1501, et seq.) A combined report is a method of accounting for the results of a unitary business and apportioning the results between jurisdictions. In the case of a multicorporate unitary business, a combined report cumulates the income and

Under the decisions of this Court, New York is permitted to tax only that income which is properly assigned or attributable to activities or sources within its boundaries. Where a unitary business in involved, this Court has held that the use of the three-factor apportionment formula results in only New York income being taxed by New York.

New York's credit for DISCs' sales does not discriminate between DISC income attributable to New York and DISC income attributable to other jurisdictions because New York claims no jurisdiction over DISC income, or any other income, properly assignable to other states and therefore assesses no tax on such income. New York's tax is measured only by income which is properly assignable to New York and its DISC credit is limited to the tax arising from DISC sales in New York.

To hold that the New York tax and credit here involved is invalid would constitute a rejection of the unitary business principle, would represent an unwarranted interference with internal state tax policy and would, as a logical consequence, require every state to assess and collect a corporate income tax at a uniform rate.

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apportionment factors of each of the unitary activities of each of the corporations and reassigns income amongst the corporations on the basis of the apportionment formula. The income and factors of any of the corporations that are unrelated to the particular unitary business are excluded from the combined report. Each individual corporation then must compute and pay its own tax based upon the total of the unitary or business income apportioned to its activities in the state and its other income assigned to the state. (Frank M. Keesling and John S. Warren, "The Unitary Concept in the Allocation of Income," 12 Hastings Law Journal 42 (1961); Frank M. Keesling, "A Current Look at the Combined Report and Uniformity in Allocation Practices," 42 Journal of Taxation 107 (1975).)

ARGUMENT

I.

WESTINGHOUSE AND EXPORT ARE ENGAGED IN A UNITARY BUSINESS; THEREFORE, THE USE OF A COMBINED REPORT OR CONSOLIDATED RETURN IS APPROPRIATE

In noting probable jurisdiction in this matter, this Court held that the second question presented by the jurisdictional statement, whether New York State's practice of combining the income of a DISC with that of its parent violates various provisions of the Constitution, was dismissed for want of a substantial federal question (Justices Stevens and Marshall dissenting on procedural grounds).

This holding is clearly correct. Nonetheless, the proper consideration and disposition of the matter before this Court is to a large extent dependent upon the unitary business principle as applied in state corporate income taxation, for it is the unitary business principle which is the linchpin of apportionability (*Mobil Oil Corp. v. Commissioner of Taxes,* (1980) 445 U.S. 425, 439). Therefore, as a preliminary matter, it is appropriate to establish that a unitary relationship exists between Westinghouse and Export.

For a unitary business to exist, there must be "contributions to income resulting from functional integration, centralization of management, and economies of scale." (*Mobil Oil Corp., supra,* 445 U.S. 438; *F. W. Woolworth Co. v. Taxation and Revenue Department,* (1982) ..... U.S. ..... [73 L.Ed. 2d 819].)

Export is a wholly owned subsidiary of Westinghouse (Joint Appendix (JA) 8 & 42). It was organized and operates as a commission agent for Westinghouse and its affiliates for export sales of products and related services (JA 9 & 42). Export is qualified as a Domestic International Sales Corporation under § 992(a) of the Internal Revenue Code (JA 8 & 42). This status provides beneficial federal tax treatment of sales made in foreign commerce in order to encourage export sales and improve the United States balance of payments (Brief of Appellant (BA) 11-13). Export's commissions were $25,987,000 in 1972, of which $19,880,000 were from Westinghouse, and $57,948,738 in 1973, of which $47,180,132 were from Westinghouse (JA 7). All other commission income was received from affiliates (JA 42-43). Export has no employees of its own and it does not own any real or personal tangible property or pay any real estate rentals (JA 9).

The relationship between Westinghouse and Export clearly satisfies the requirements of *Mobil* and *Woolworth* for the finding of a unitary business. Export's existence and ability to function are solely related to its parent company's desire to obtain preferential federal tax treatment for export sales. It is functionally integrated in the fullest sense possible. It is centrally managed *and staffed,* as shown by its lack of employees or an office (JA 9). It gives rise to economies of scale as a device created to facilitate increased sales of Westinghouse products. Its contribution to the income of the Westinghouse group through reduced or deferred federal taxation is direct and apparent. To paraphrase the Court's decision in *Mobil:*

> "Transforming the same income [of Westinghouse] into [the income of Export] works no change in the

underlying economic realities of a unitary business, and accordingly it ought not to affect the apportionability of the income. . . ." (445 U.S. 441.)

II.

AS REQUIRED BY THE DUE PROCESS CLAUSE OF THE FOURTEENTH AMENDMENT, NEW YORK STATE IS TAXING ONLY INCOME WHICH IS PROPERLY ATTRIBUTABLE TO ACTIVITIES OR SOURCES WITHIN ITS TAXING JURISDICTION

Westinghouse, in its Jurisdictional Statement, made no allegation that the New York tax and credit here in issue give rise to the taxation of extraterritorial values or violate the Due Process Clause of the Fourteenth Amendment. But now for the first time in the Brief of Appellant, Westinghouse asserts that New York is taxing extraterritorial values. It does so by stating that New York taxes the total income of Export (BA 6, 9 & 17) and by alleging that the failure to include the factors of Westinghouse affiliates for which Export makes commission sales in the apportionment formula subjects all of Export's income to tax (BA 6, 20-22). Not only is this argument inappropriate and not properly before this Court (Rule 15.1(a) *Quilloin v. Walcott* (1978) 434 U.S. 246, 253 Fn 13; *Phillips Chemical Co. v. Dumas School District* (1960) 361 U.S. 376, 386 Fn 12), it is also in error.

In *Exxon Corp. v. Wisconsin Department of Revenue* (1980) 447 U.S. 207 at 220, this Court restated its previous determination that the Due Process Clause of the Fourteenth Amendment requires that for a state tax to be valid there must be " 'a rational relationship between the income attributed to the State and the intrastate values of the

enterprise.' Mobil Oil Corp., supra. See Moorman Mfg. Co. v. Bair [437 U.S. 267] at 272-273 . . . National Bellas Hess, Inc. v. Department of Revenue, 386 U.S. 753, 756 . . . Norfolk & Western R. Co. v. State Tax Comm'n, 390 U.S. 317, 325. . . ." This Court then went on to reaffirm its position that when a taxpayer is a unitary business, "a State may apply an apportionment formula to the taxpayer's total income in order to obtain a 'rough approximation' of the corporate income that 'is reasonably related to the activities conducted within the taxing State.' Moorman Mfg. Co. v. Bair, ..." (*Id.* at 223.) For a taxpayer to successfully attack an apportionment formula, it must show extraterritorial values are being taxed. (*Butler Brothers v. McColgan* (1942) 315 U.S. 501; *Mobil Oil Corp. v. Commissioner of Taxes, supra,* 445 U.S. 425; *Exxon Corp. v. Wisconsin Department of Revenue, supra,* 447 U.S. 207.)

Westinghouse attempts to meet this burden by stating that the formula used by New York excludes the "affiliates' receipts, property and payroll from the apportionment formula." But New York is not including the income of Westinghouse's affiliates in the base to which it applies its apportionment formula. Therefore, there is no reason to include the affiliates' factors in the apportionment formula. To include the factors of the affiliates would cause the formula to assign part of the income to the affiliates when there has been no allegation the affiliates are part of the unitary business. Furthermore, Westinghouse neglects to mention that Export's commissions from affiliates are included in the apportionment formula and that none of these commissions are assigned to New York (JA 17). New York

has included Export's income in the base subject to apportionment and therefore has correctly included Export's factors in the apportionment formula.

III.

THE NEW YORK CREDIT FOR DISC SALES DOES NOT DISCRIMINATE AGAINST DISC SALES MADE FROM OTHER STATES AND THEREFORE DOES NOT VIOLATE EITHER THE COMMERCE CLAUSE OR THE EQUAL PROTECTION CLAUSE OF THE FOURTEENTH AMENDMENT

The gravamen of Westinghouse's argument is that "the franchise tax in this case imposes a greater tax liability on out-of-state sales than on in-state sales . . ." (JA 10). This statement is simply not true.

A necessary premise to the argument advanced by Westinghouse is that New York is taxing sales or more properly, income, attributable to other states (BA 16, 17 & 20). For if New York is taxing only New York income, there can be no discrimination or denial of equal protection with respect to sales or income arising in other states. New York would be doing nothing with respect to such sales or income.

That is precisely the fact in this case. As shown in Argument II above, the Due Process Clause of the Fourteenth Amendment restricts New York's power of taxation to income properly attributable to New York. The taxation of any other income would be impermissible. Since New York is not taxing income or sales from other jurisdictions, it is impossible for it to discriminate against such sales or income or to deny equal protection with respect to such sales or income.

Westinghouse, in its brief, relies on this Court's decisions in *Boston Stock Exchange v. State Tax Commission* (1977) 429 U.S. 318 and *Maryland v. Louisiana* (1981) 451 U.S. 725, but ignores the critical distinctions between the incidences of taxation in those cases and the New York tax here involved.

In *Boston Stock Exchange*, the tax involved was a transfer tax. The tax was imposed on residents and nonresidents on any sale, agreement to sell, memoranda of sales, delivery or transfer of equity securities occurring in New York. If any one of the incidents of taxation occurred in New York, the tax was imposed and based on the *total* value and number of shares involved. Whether the transactions were wholly intrastate or included interstate elements, they were taxed in full. After the tax was determined, a credit was then given to encourage use of New York exchanges.

In *Maryland v. Louisiana*, the tax involved was a "first-use" tax on the *full* quantity of gas imported into Louisiana that had not previously been subject to tax. Exemptions and credits from the tax were granted to users within Louisiana and for parties subject to the Louisiana severance tax.

In both cases, the tax was applied to the full value of the transaction. No effort was made to apportion the tax in any manner. In the instant case, there has been a full apportionment and the tax here assessed and credit here granted apply only to New York activities.

The deficiencies in Westinghouse's position are shown by two simple examples.

First, let us suppose that New York had determined to abolish its income tax with respect to DISC sales by refusing to include any DISC income in the apportionable base. Although this would make New York a more attractive place from which to make DISC sales, would this be constitutionally impermissible? Clearly not. In fact, it would place New York on an equal footing with a number of other states including several out of which Westinghouse's DISC sales are presumably made. (Prentice Hall All-States Tax Handbook-1983 ¶ 222-A)

Second, what if New York had gone a step further and had abolished its corporate income tax? It would certainly make New York a more attractive state for any business to locate or to concentrate its activities in as compared to states with corporate income taxes. Would this be invalid? Of course not. But the logical consequence of accepting Westinghouse's argument is that the abolition of the corporate income tax would be invalid. Furthermore, it would require the Court not only to establish corporate income taxes for Nevada, South Dakota, Texas, Washington and Wyoming but also to establish uniform rates for all states.

Westinghouse, in its argument, ignores the closing admonition of *Boston Stock Exchange v. State Tax Commission, supra,* 429 U.S. 318, 336-37, that "Our decision today does not prevent the States from structuring their tax systems to encourage the growth and development of intrastate commerce and industry. Nor do we hold that a State may not compete with other States for a share of interstate commerce; such competition lies at the heart of a free trade policy. We hold only that in the process of competition no State may discriminatorily tax the products manufactured or the business operations performed in any other State."

CONCLUSION

New York, through the application of a three-factor apportionment formula to the consolidated or combined income of Westinghouse and its unitary subsidiary Westinghouse DISC, has determined the amount of income which is properly attributed to New York. New York has the right, as does every other state, to tax the income in full, in some part or not at all. The exercise of this right by New York to compete with its sister states for export sales activity in the circumstances of this case in no way discriminates against either interstate or foreign commerce and does not deny Westinghouse equal protection under the law as required by the Fourteenth Amendment. Thus, the New York tax should be sustained.

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No. 81-2394-ASX
Status: GRANTED

Title: Westinghouse Electric Corporation, Appellant
v.
James H. Tully, Jr., et al.

Docketed:
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Court: Court of Appeals of New York

Counsel for appellant: Dodyk,Paul M.

Counsel for appellee: Abrams,Robert, Schiff,Peter H.

Entry	Date	Note	Proceedings and Orders
1	Jun 30 1982	G	Statement as to jurisdiction filed.
2	Jul 29 1982		Motion of appellee James H. Tully, etc. to dismiss or affirm filed.
3	Aug 4 1982		DISTRIBUTED. September 27, 1982
4	Aug 24 1982	X	Reply brief of appellant Westinghouse Elec. Corp. filed.
5	Jan 3 1983		REDISTRIBUTED. January 7, 1983
8	Jan 10 1983		REDISTRIBUTED. January 14, 1983
10	Jan 17 1983		In this case, probable jurisdiction is noted limited to Question 1 presented by the statement as to jurisdiction. With respect to Question 2 presented by the statement as to jurisdiction, the appeal is dismissed for want of a substantial federal question. Justice Stevens, joined by Justice Marshall, dissenting: While I agree with the Court's conclusion that the second question in the jurisdictional statement is insubstantial, I do not believe a court of law has the power simultaneously to dismiss and to accept jurisdiction of a single appeal from a single judgment. I therefore do not join the Court's order. **********
12	Feb 16 1983		Order extending time to file brief of appellant on the merits until April 2, 1983.
13	Mar 16 1983		Order further extending time to file brief of appellant on the merits until May 2, 1983.
14	May 4 1983		Joint appendix filed.
15	May 4 1983		Brief of appellant Westinghouse Elec. Corp. filed.
17	May 13 1983		Order extending time to file brief of appellee on the merits until July 2, 1983.
18	May 14 1983		Record filed.
19	Jun 17 1983		Order further extending time to file brief of appellee on the merits until July 16, 1983.
20	Jul 14 1983		Brief amicus curiae of California filed.
21	Jul 15 1983	X	Brief of appellees James H. Tully, et al. filed.
22	Aug 15 1983		CIRCULATED.
23	Sep 21 1983		SET FOR ARGUMENT. Tuesday, November 1, 1983. (3rd case) (1 hour)
24	Oct 25 1983	X	Reply brief of appellant Westinghouse Elec. Corp. filed.
25	Nov 1 1983		ARGUED.

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